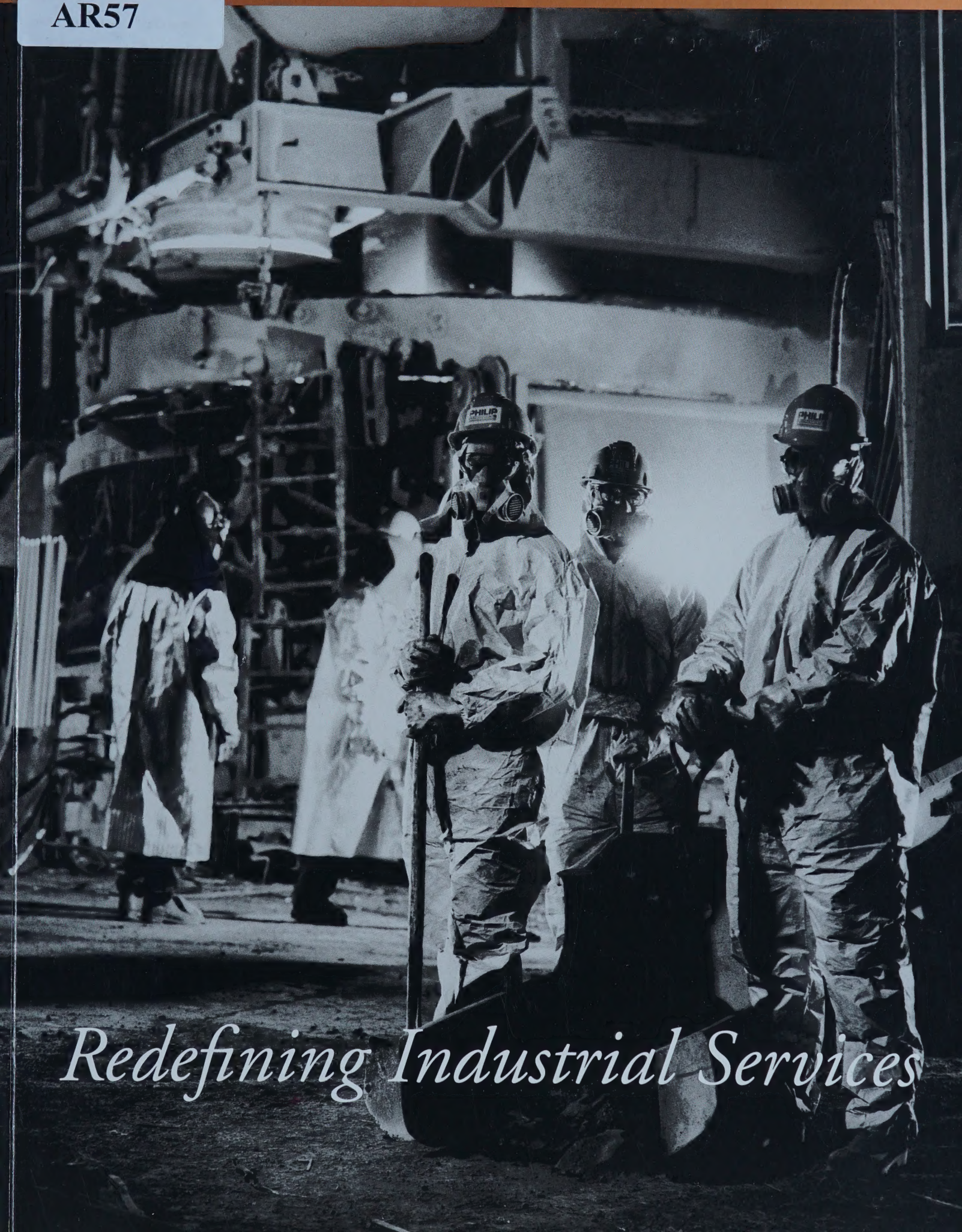


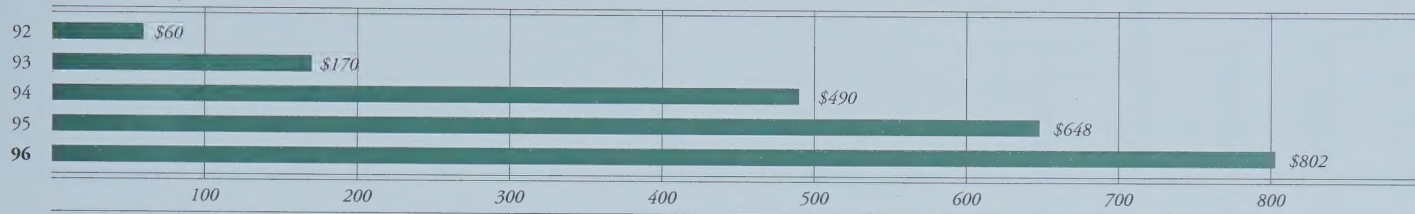


Redefining Industrial Services

Financial Highlights

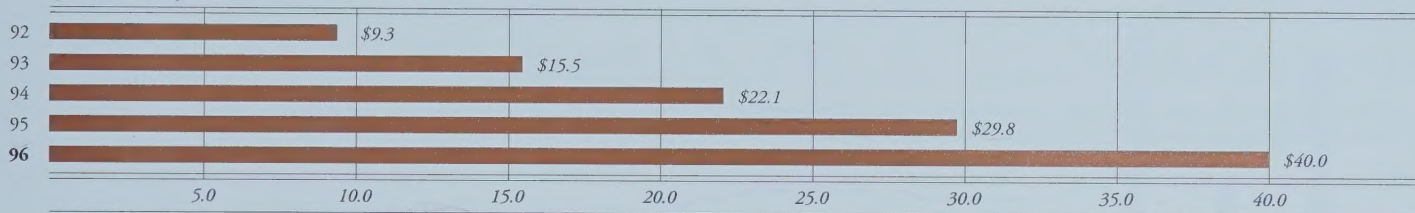
Revenue*

(\$Cdn millions)



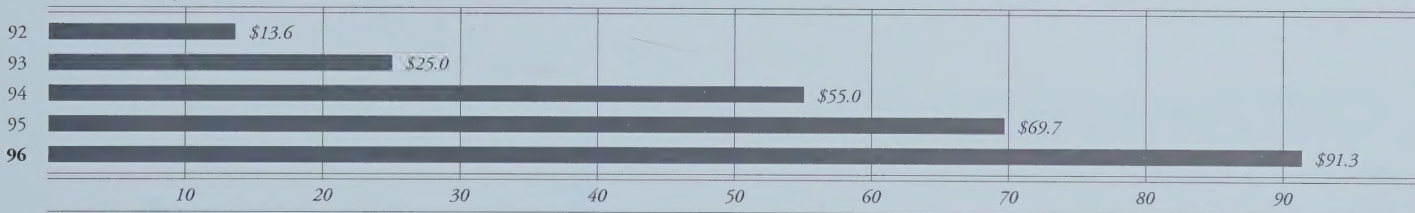
Net Earnings*

(\$Cdn millions)



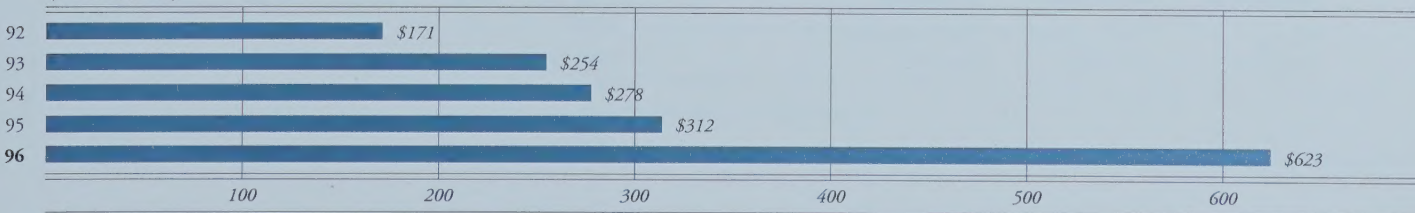
Cash Flow from operations*

(\$Cdn millions)



Shareholders' Equity

(\$Cdn millions)



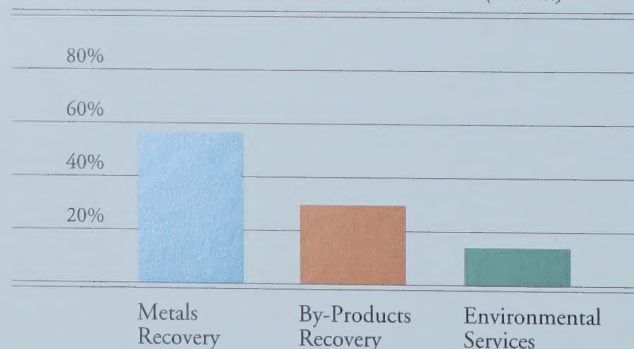
* From Continuing Operations

Financial Highlights

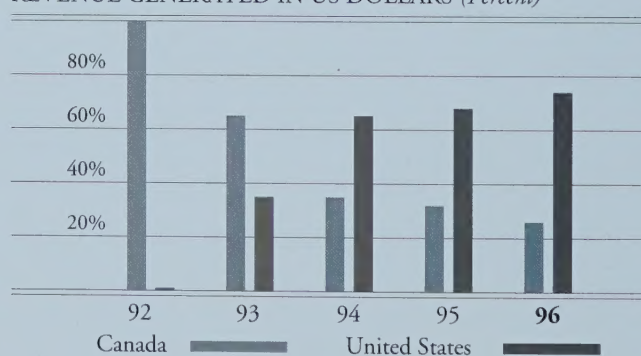
(in thousands of Canadian dollars, except per share amounts)	Years Ended December 31				
	1996	1995	1994	1993	1992
Revenue*	\$ 802,490	\$ 648,311	\$ 489,740	\$ 170,283	\$ 60,401
Net earnings*	\$ 40,013	\$ 29,817	\$ 22,124	\$ 15,492	\$ 9,344
Cash flow before changes in non-cash working capital*	\$ 91,280	\$ 69,654	\$ 54,981	\$ 24,998	\$ 13,602
Long-term debt, net of current maturities	\$ 387,431	\$ 250,662	\$ 234,663	\$ 152,478	\$ 107,421
Shareholders' equity	\$ 623,351	\$ 312,102	\$ 277,882	\$ 253,675	\$ 171,008
Total assets	\$ 1,345,719	\$ 1,002,912	\$ 860,583	\$ 717,925	\$ 348,101
Common shares outstanding (in thousands)	69,877	37,454	37,271	35,906	31,812
Basic earnings per share*	\$ 0.79	\$ 0.80	\$ 0.61	\$ 0.47	\$ 0.31
Fully diluted earnings per share*	\$ 0.72	\$ 0.68	\$ 0.55	\$ 0.43	\$ 0.29

These financial highlights should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements.

DIVERSIFICATION OF 1996 REVENUE BASE (Percent)*

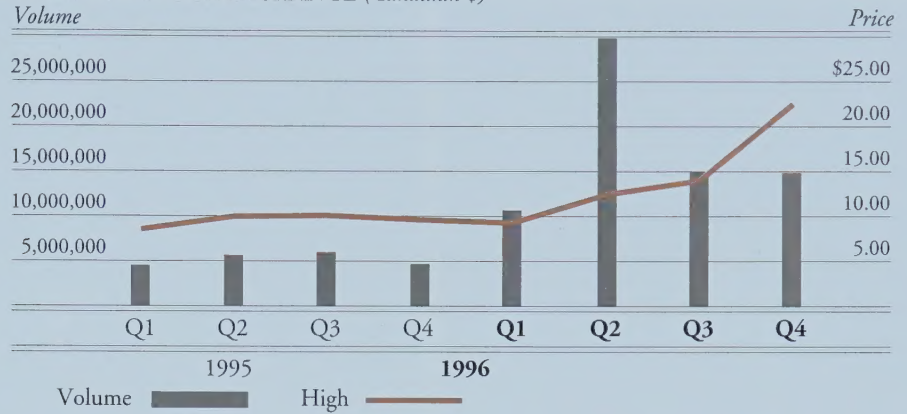


REVENUE GENERATED IN US DOLLARS (Percent)*

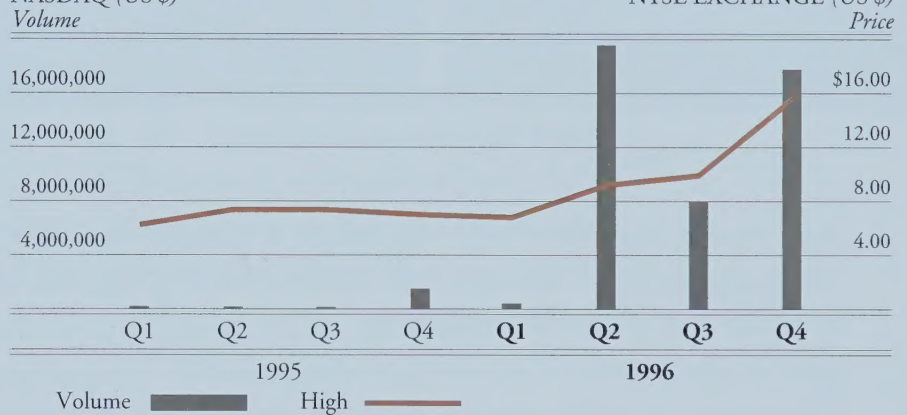


* From Continuing Operations

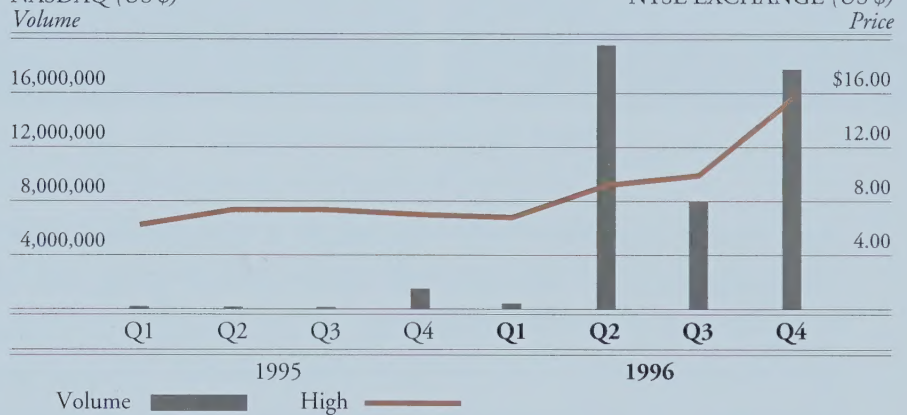
TORONTO STOCK EXCHANGE (Canadian \$)



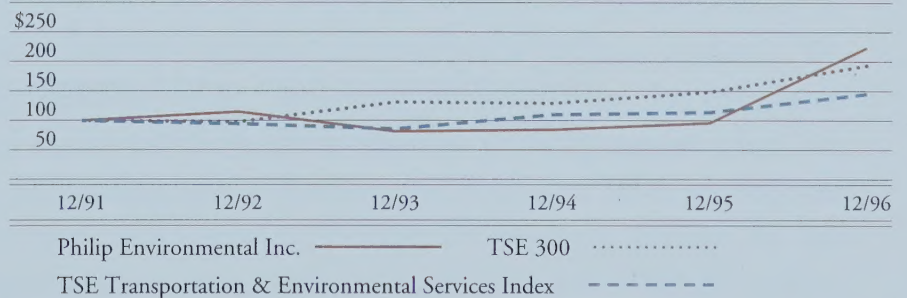
NASDAQ (US \$)



NYSE EXCHANGE (US \$)



COMPARISON OF FIVE YEAR CUMULATIVE TOTAL RETURN* (\$ Canadian)



* \$100 Invested on 12/31/91 in stock or index, including reinvestment of dividends, for fiscal years ending December 31.

1996 Corporate Objectives

Objective: To consolidate our position as the leader in the resource recovery and industrial services market.

Results: Philip consolidated its market position through focusing its business on servicing key industry sectors. Through strategic acquisitions concluded in 1996 and early 1997, the Company now has a revenue run rate of approximately \$1.7 billion and has broadened the scope and geographic distribution of its resource recovery and industrial services.

Objective: To increase shareholder value, stock liquidity and the US investor base.

Results: Philip issued 8.6 million new common shares and listed on the New York Stock Exchange. By the end of 1996, the price of the Company's common shares had increased substantially and common shares held by US investors had increased from 10% to over 60%. Total common shares outstanding at December 31, 1996 increased to 69.9 million.

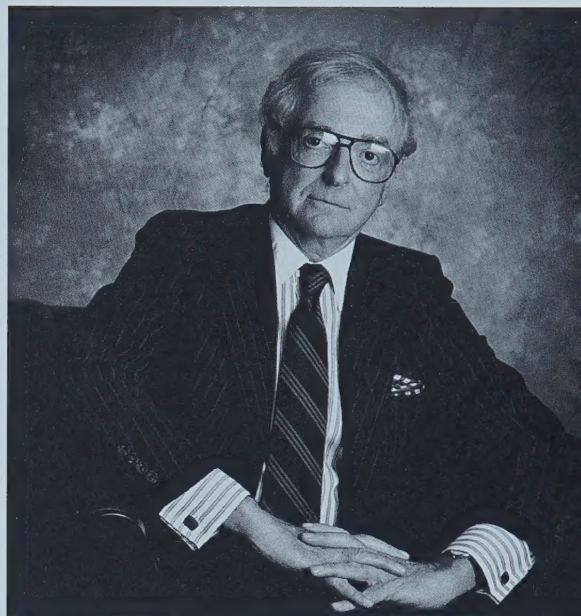
Objective: To strengthen the Company's balance sheet to sustain future growth.

Results: Through the sale of the Company's municipal solid waste business and 30% of its water utilities business, and the conversion of all outstanding convertible subordinated debentures into common shares, Philip reduced its debt. The Company also established a new US\$550 million credit facility.

To Our Shareholders



Allen Fracassi
President & Chief Executive Officer



Howard Beck, Q.C.
Chairman of the Board

In 1995, Philip had reached a crossroad. Our industrial clients were fundamentally changing the way they did business. Outsourcing and vendor reduction were driving market expansion. We knew as a company what our strengths were. We also knew what we had to do to keep moving ahead - strengthen our balance sheet, increase our profile in the United States both financially and in the marketplace, and develop a more focused approach to our business. Our response was quick and decisive.

In February 1996, we announced that our business would concentrate on the fast growing resource recovery and industrial services market. We created 'a new box' for Philip, distancing ourselves from the traditional environmental sector and focusing on this fast growing market where we could become the leading service provider. By September 1996, we had sold our municipal solid waste business, brought in an equity partner for our utilities management company, and put in place a new US\$550 million credit facility to support our expansion program.

For Philip Environmental, 1996 was an historic year. The Company now has a revenue run rate of approximately \$1.7 billion, as a result of strategic acquisitions. Earnings from continuing operations for the year reached a record \$40 million.

To Our Shareholders

From the beginning, our success has been driven by finding new ways to turn one industry's waste into another industry's raw material. By refocusing our business, our past has become our future. Our ability to see trends and seize opportunities continues to differentiate us. In the seventies and early eighties, the environmental industry was driven by regulations. We were one of the first to see beyond waste management and define the possibilities of resource recovery. Today, the environmental regulatory framework is well established and the driving market force is economics - to reduce costs and continuously improve operating performance.

Companies are contracting out non-core services to specialists who can provide increased efficiency and accountability at reduced costs. Companies are looking for suppliers with a range of services so that they can reduce the number of vendors they deal with and lower their administrative costs. They want suppliers to truly act as their partners.

Our strong relationships with the steel industry are a perfect example of this new economic reality. We provide scrap metal to feed their furnaces, but this is only one component of our integrated service approach. We handle their waste streams, deliver their on-site maintenance and industrial cleaning, and even provide final processing and distribution of their products. In return, our clients improve their efficiencies, lower their administrative costs and concentrate on what they do best - their core business. Our integrated approach to the steel industry provides a blueprint that we are replicating to service other industrial sectors.

The growing resource recovery and industrial services sector is fragmented. A significant number of the companies in this sector are privately held. Many of these companies have neither the financial nor the organizational resources needed to serve the changing market. We have the opportunity to be the market consolidator. To achieve this goal, we have now created two distinct acquisition programs. One focuses on large strategic acquisitions, while the other targets smaller 'tuck-in' acquisitions to broaden our service mix in areas of heavy industrial concentration.

We are also setting our sights globally. Through the acquisition of Allied Metals Limited in early 1997, a steel scrap and mill services company in the United Kingdom, we have established a base for our

expansion into the European marketplace. There is a tremendous opportunity for us to work in partnership with our multinational clients and to establish in Europe the same integrated service approach that has driven our growth in North America. The standardization of waste minimization and diversion targets by the European Union is creating significant markets for industrial by-products recovery.

We are not, however, ignoring our internal growth opportunities which are in part driven by new technologies. Our patented EPOC paint overspray recovery system is a prime example. Installed at over 20 parts manufacturing and automotive assembly plants, the EPOC process captures paint overspray in a solvent based emulsion for recovery and reuse. We have also been chosen by BASF, one of the world's largest chemical companies, to construct and operate the first polyurethane recycling plant in North America. With initiatives like these, we will meet our strong internal growth targets.

In addition, we are developing Master Service Agreements with our key clients which formally place Philip on a short list of approved suppliers. Vendor reduction has signalled a major shift in supplier customer relationships and Master Service Agreements are now a prerequisite for doing business with most Fortune 500 companies. For example, BASF is using its Supply Management Program in the NAFTA region to consolidate from 20,000 to 1,500 vendors. Currently, Philip has established Master Service Agreements with BASF and eighteen other major corporations.

Today, Philip has never been stronger. The demand for our services is expanding across North America and into Europe, and our solid financial performance is reflected in our growing share price. We have a strong balance sheet and unparalleled resources in our team of management and employees that together will drive our growth in 1997.

A handwritten signature in black ink, appearing to read 'Allen Fracassi', with a large, loopy initial 'A'.

Allen Fracassi,
President & Chief Executive Officer

A handwritten signature in black ink, appearing to read 'Howard Beck', with a large, loopy initial 'H'.

Howard Beck,
Chairman of the Board

- 1996
- Sale of Quebec solid waste business for \$53 million.
 - Launch of Philip's new strategy to become the leading provider of resource recovery and industrial services - "Creating a New Box".
 - Acquisition of the environmental laboratory business of Zenon Environmental to expand Philip's analytical service capabilities.
 - Issued 8.625 million common shares at \$9.54 per share for net proceeds of \$76.1 million.
 - Philip common shares listed on New York Stock Exchange.
 - Philip acquired the aluminum processing assets and business of Cousins in Ohio.
 - Approval received to expand Taro solid non-hazardous industrial landfill, which has an annual fill rate of 825,000 tons and an 11 million ton capacity.
 - Sale of the remainder of the municipal and commercial solid waste business for US \$115 million.
 - Acquisition of Reclaimers adds a wire and cable chopping business located in Indiana.
 - Philip awarded ten year contract to manage on-site wire and cable scrap operations for a US regional telecommunications company.
 - New four year US\$550 million credit facility established.
 - Remaining convertible subordinated debentures converted into common shares of the Company.
 - Philip chosen by BASF to construct and operate the first polyurethane recycling facility in North America.
 - The Ontario Teachers' Pension Plan Board invested \$10 million for a 30% interest in Philip Utilities, the water and wastewater management subsidiary.
 - The business of IAM Environmental was acquired - a leading asbestos abatement business in Houston, Texas.
 - Acquisition of Intsel Southwest Limited Partnership of Houston, Texas, a large US heavy carbon steel products distributor.
 - Philip acquired the Luntz Corporation, a ferrous processing and mill services company in the USA, with seven facilities in Ohio.
 - Acquired an aluminum alloys plant in Guelph, Ontario, to establish Philip as a major supplier of aluminum alloys to the automotive industry.

The building process continued by:

- 1997
- Acquiring the assets and business of Allied Metals Limited, a steel scrap processing and mill services businesses in the UK.
 - Acquiring RMF Global Inc., an industrial maintenance and mechanical services company in Toledo Ohio, and
 - Acquiring Conversion Resources Inc., of Cleveland, Ohio and Warrenton Resources Inc., of Warrenton, Missouri to add non-ferrous processing and refining capabilities.



Philip Fracassi,
Executive Vice-President & Chief Operating Officer

METALS RECOVERY

Services	Employees:	Facilities:	Industry Sectors Served
Copper and Aluminum Recovery & Processing	1,180	Aluminum Processing: 4	Aluminum
Materials Recycling Facilities Management		Ferrous Processing/ Mill Services: 12	Automotive
Ferrous Scrap Processing		Steel Distribution Centres: 6	Copper & Brass Mills
Steel Processing & Distribution		Non-ferrous Processing: 10	Steel
Mill Services		Landfills: 2	Telecommunications
Aluminum Dross Recycling			Wire and Cable
Deox & Alloy Production			
Plastics Recycling			

BY-PRODUCTS RECOVERY

Services	Employees:	Facilities:	Industry Sectors Served
Fuel Blending	1,497	Transfer and Processing	Automotive
Solvent Distillation		Facilities: 35	Aviation
Polyurethane Recycling		Landfills: 1	Chemical
Paint Overspray Recovery System (EPOC)			Paint & Coatings
Inorganic Waste Processing			Petrochemical
Household Hazardous Waste			Transportation
High Pressure Wash & Vacuum Services			

ENVIRONMENTAL SERVICES

Services	Employees:	Facilities:	Industry Sectors Served
Demolition & Remediation	824	Service Centres: 18	Automotive
Industrial Cleaning & Maintenance		Laboratories: 5	Food & Beverage
Fabrication			Oil & Gas
Abatement			Petrochemical
Strategic Resource Management			Pulp & Paper
Analytical			Railways/Transportation
Emergency Response			Steel
			Utilities



Metals Recovery Group ■ By-Products Recovery Group ▲ Environmental Services Group ●



Metals Recovery

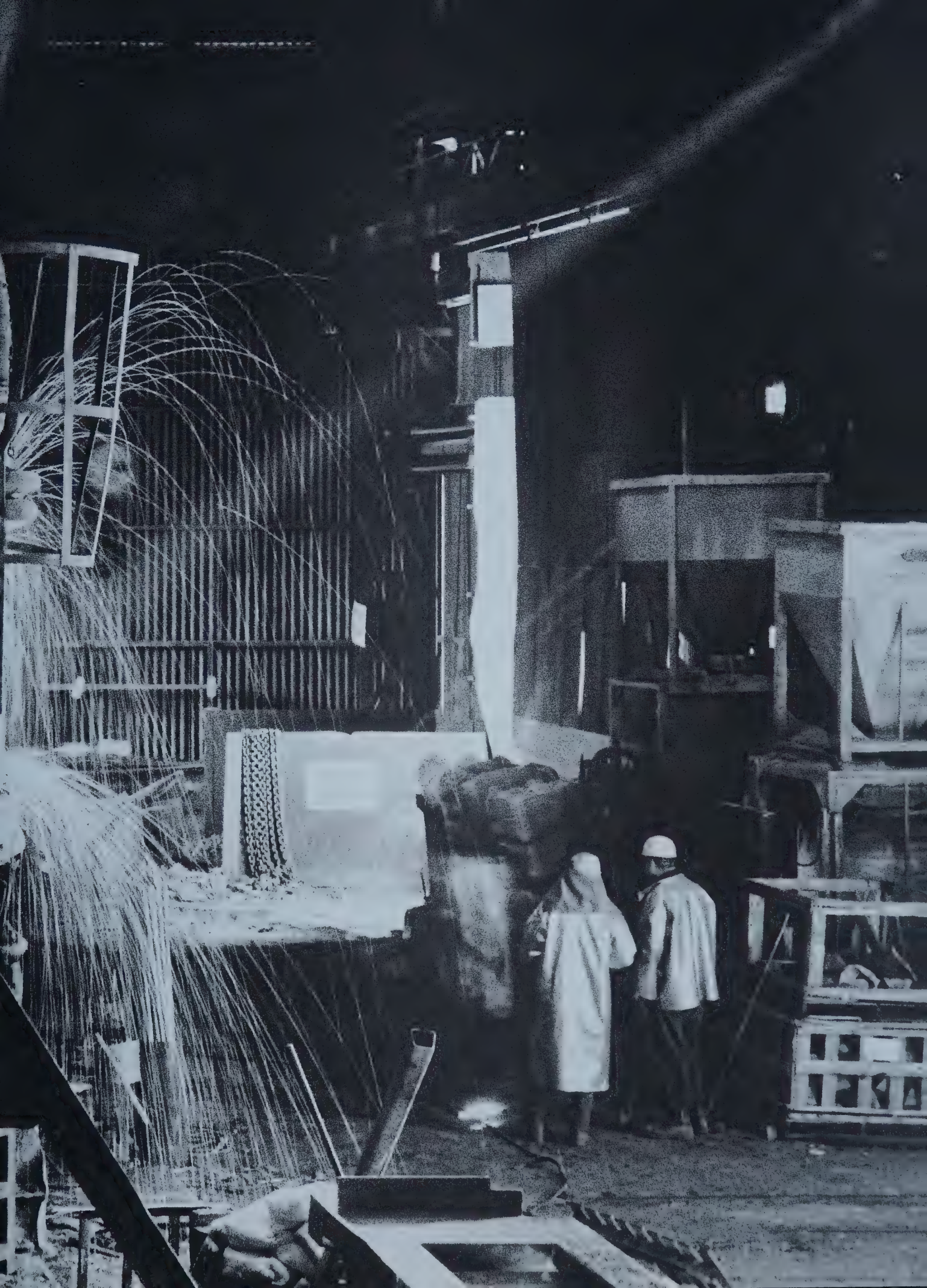
Philip's corporate culture of turning one industry's waste into another's raw material, developed from our early partnerships with the steel industry, when we processed foundry sand for reuse in cement production. Today, our processing and in-plant services encompass each step of the steel making process.

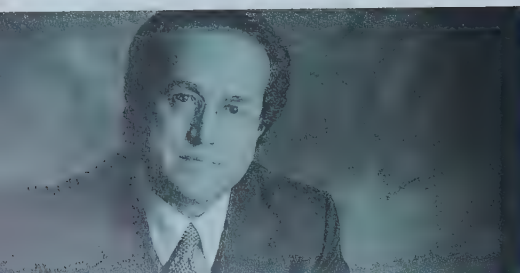
We recover steel scrap, and iron from by-products of steel manufacturing such as sludge and millscale. We supply recovered iron and processed scrap as a raw material in steel production. We also purchase end products from steel companies and provide value-added processing and distribution services.

Through technology and strategic acquisitions, Philip has become a leading supplier of integrated ferrous processing and steel mill services at all steps in the manufacturing process.

Philip provides services, such as the recovery of iron from the by-products of steel manufacturing, for clients like Slater Steel whose electric arc furnace in Hamilton, Ontario is pictured here.





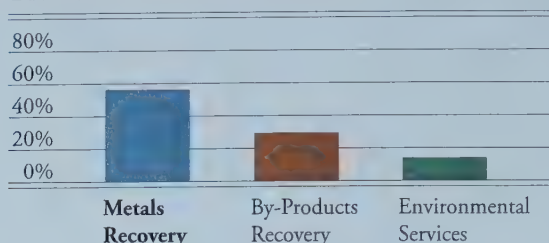


Robert Waxman, President,
Metals Recovery Group

"Our goal is to establish a balance between our secondary scrap operations, such as copper, steel and aluminum and the production of finished products such as deox, prime ingots and alloys which command higher prices and add value to our scrap metal operations."

"Through our comprehensive service package to the steel industry, we have developed the template from which to expand our approaches to other key industry sectors."

DIVERSIFICATION OF 1996 REVENUE BASE (Percent)*



* From Continuing Operations

In 1996, Philip aggressively expanded its already strong position in the processing and recovery of scrap metals, principally steel, copper and aluminum. We have expanded our wire and cable processing capacity to meet market demand, and the acquisitions of the Luntz Corporation, an aluminum alloys plant, Cousins aluminum recovery business and Intsel Southwest clearly strengthen our industrial service mix. In early 1997, our acquisition of Conversion Resources and Warrenton Resources broadened our copper processing capabilities, while the acquisition of Allied Metals in the UK established our metals recovery services in the international market and provided a base for future European expansion.

Ferrous Processing and Mill Services

The steel industry is reducing vendors, contracting with suppliers to provide non-core services and rapidly increasing production from electric arc furnaces. The result is an increased demand for scrap iron and steel and significant opportunities for integrated service providers. For Philip, ferrous processing and mill services is a business where we have extensive experience, strong technology and a leadership position. We have differentiated ourselves by offering fully integrated services to the market from providing raw materials to mid-processing through to product distribution.

With demand for scrap steel to feed electric arc furnaces rapidly increasing, Philip has increased its steel scrap processing capabilities from 450,000 tons to over 2 million tons through acquisitions and capital improvements. Our acquisition of the Luntz Corporation provides Philip with seven operations to service the heavy concentration of steel industries throughout Ohio. With the acquisition of Allied Metals Limited, we are a leading participant in the recycled metal market in the United Kingdom. Allied Metals also recovers copper, aluminum and zinc from automotive shredder fluff, using a proprietary technology which we will bring to our North American operations.



Ferrous Scrap Processing

Electric arc furnaces ("EAF") operate by charging scrap steel with carbon and other additives to produce the melt for casting. The increase in EAF production is creating global demand for scrap steel and alternate sources of iron units as raw materials. Philip has the capability to process over 2 million tons of steel scrap annually. In addition, we are developing the technology to recover iron from EAF dust, a by-product of steel manufacturing.



Copper Recovery

Our copper recovery business typifies our role as an essential mid-processor, applying proprietary technology to convert by-products and scrap into raw material for reuse. Virtually every component of the scrap wire and cable is recycled.

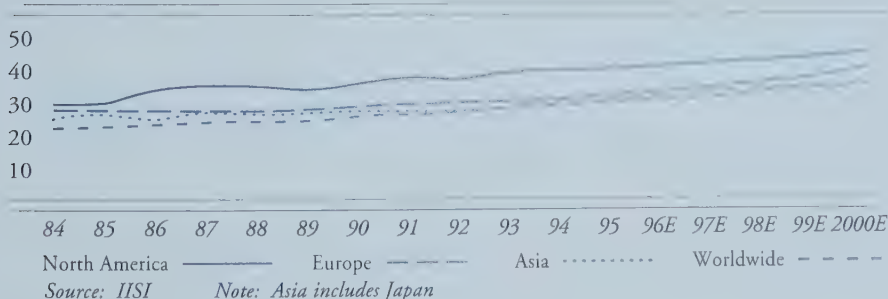
Wire and cable scrap is purchased from manufacturers and the telecommunications industry. The material is fed through a series of granulators to separate the metal from the plastic insulation.



The recovered copper is processed into prime copper or is sold directly to brass and copper mills as a raw material. Using a proprietary plastics recycling system, the insulation is recycled for reuse in the manufacturing of automotive parts.

Philip is a leading processor of scrap wire and cable in North America. In 1996, we significantly increased our processing capacity to meet market demand.

Proportion of steel produced with electric arc furnaces (Percent)



Services are being added at every step of the manufacturing process. We are recovering steel from by-products such as mill scale, sludges and dusts and providing this material back to the mills in a processed form for reuse. The acquisition of Intsel, a large structural steel processor and distributor, provides Philip the capacity to provide a complete service package to mills including final processing and distribution of steel products.

Copper

Philip is a leading processor of scrap wire and cable. Significant opportunities for our services are also emerging through outsourcing by the telecommunications industry. In 1996, we were awarded contracts by three regional telecommunications companies to provide management of their wire and cable recycling programs. These contracts provide us with the ability to serve other regional clients as well as an increased volume of material for our processing facilities.

Early in 1997, we acquired Warrenton Resources, whose refinery is the sole manufacturer of fire-refined copper ingot in North America. In the past, because we lacked facilities to completely process copper, we either sold copper scrap to brass mills or traded scrap for prime material to honour our contractual arrangements. With Warrenton Resources, we now process copper scrap into value-added prime material. In 1997 we will be expanding our capacity at this facility in order to upgrade more of the copper reclaimed from our wire and cable processing activities.

Aluminum

Two acquisitions in 1996 significantly broadened our aluminum recycling operations and our service mix to key industrial sectors. The acquisition of the aluminum processing assets and business of Cousins established Philip as the significant manufacturer of deoxidizing agents ("deox") in North America to support our steel mill services business. Deox is manufactured from aluminum scrap, and is used to eliminate gas bubbles in cast steel. Large steel facilities can use up to a million pounds of deox a month.

The acquisition of an aluminum alloys plant was our second major aluminum acquisition. This facility manufactures aluminum alloys for engine manifolds, pistons, casings and wheels, and complements the extensive range of services Philip provides to the automotive industry.



Aluminum Deox

Oxygen plays an important role in steel manufacturing, speeding combustion in the refining process. But if any residual oxygen gets trapped in the molten steel, bubbles and flaws can form in the casting. For a solution, the steel industry looks to another metal - aluminum. Aluminum deox, added in small quantities to the molten steel, creates a chemical reaction which removes the dissolved gas.

Philip is now a major producer of deox in North America.

At our facility in Ohio, deox is manufactured by processing aluminum scrap into cones, shots and ingots. Steel mills, each with their own specifications, can use up to one million pounds of aluminum deox a month.

Aluminum Alloys

Philip has expanded its strong market position in the recycling of aluminum dross generated by primary smelters and is also a major supplier of aluminum alloys to the automotive industry.

At our facility in Guelph, Ontario, scrap and prime aluminum are combined with other metals to produce alloys which are transported to market in specialized vessels in either ingot or molten form. These alloys are used to manufacture engine manifolds, pistons, casings and wheels. As automotive manufacturers increasingly look to aluminum parts to reduce vehicle weight, we expect the market opportunities for alloys will continue to grow.

By-Products Recovery

Philip and Canadian National Railways, the sixth largest railroad in North America, have developed an innovative partnership. To reduce the number of suppliers and program costs, CN has awarded Philip responsibility for waste management at all of its sites across North America.

CN's MacMillan Yard in Toronto, Ontario is the largest marshalling and switching yard in Canada. Over 1700 cars per day are classified, assembled into trains and routed to their final destination. It is also one of CN's largest diesel repair and maintenance facilities. Here, Philip provides industrial cleaning, analytical and waste management services including the recycling of spent solvents, oils and filters.

Philip has established a database that will greatly enhance CN's waste reporting and invoicing systems and will be used to develop more efficient waste reduction and recovery alternatives.

Philip provides industrial vacuum service at CN's Locomotive Reliability Centre in Toronto, Ontario.



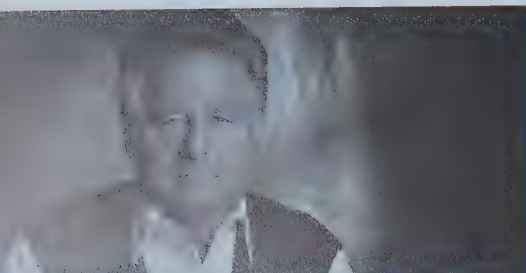


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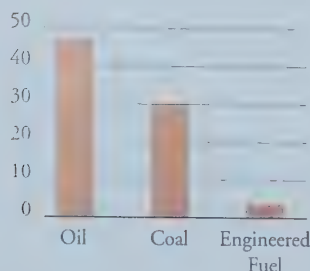


Norman Foster, President
By-Products Recovery
Group

"Economics drive our business, not regulations. Waste is just a visible manifestation of inefficiency. Our strength is in recovering technologies which reduce waste and improve recovery, which ultimately provides our clients with a competitive advantage."

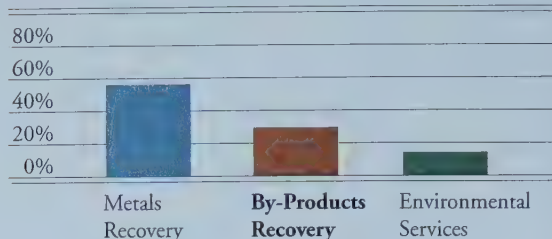
"In three years time, the By-Products Recovery Group will be considerably different than it is today. In 1996, most of our business was in traditional services such as fuel blending and distribution. In three years, we expect that national programs and new business driven by emerging technologies will generate over half of our revenue."

Cost Comparison of Alternate Fuels to Cement Kilns (\$US)



Approximate Cost (\$US) / Ton of Clinker
Cement manufacturing requires typically
4.9 million BTU's to produce one ton of clinker.

DIVERSIFICATION OF 1996 REVENUE BASE (Percent)*



* From Continuing Operations

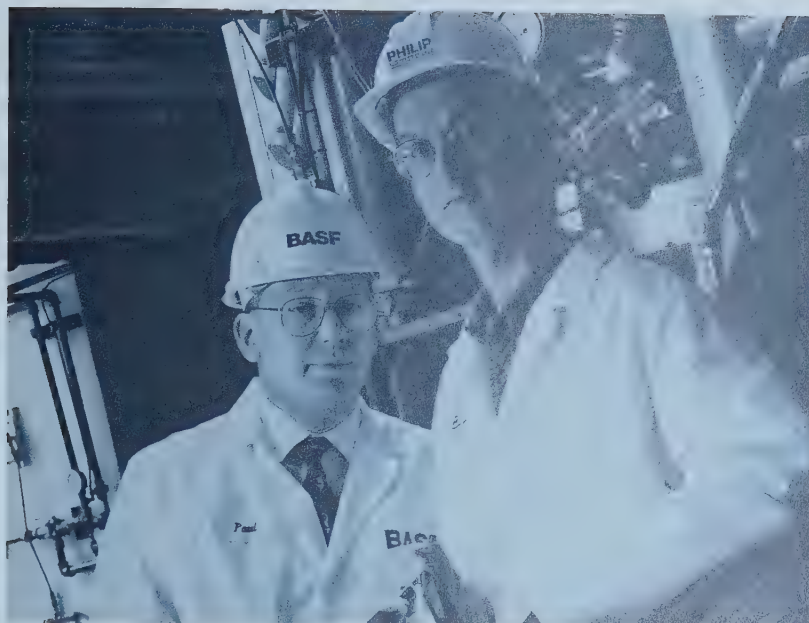
Nowhere has the change in the regulatory environment had

more impact than in the management of industrial by-products and wastes. For more than a decade, the rapid rise of regulations created huge markets for industrial waste management, particularly involving hazardous waste, but it was an artificial economy that could not support the excess capacity created. Since then, the industry has undergone an enormous transformation. Companies, both large and small, have exited the business and consolidation is underway.

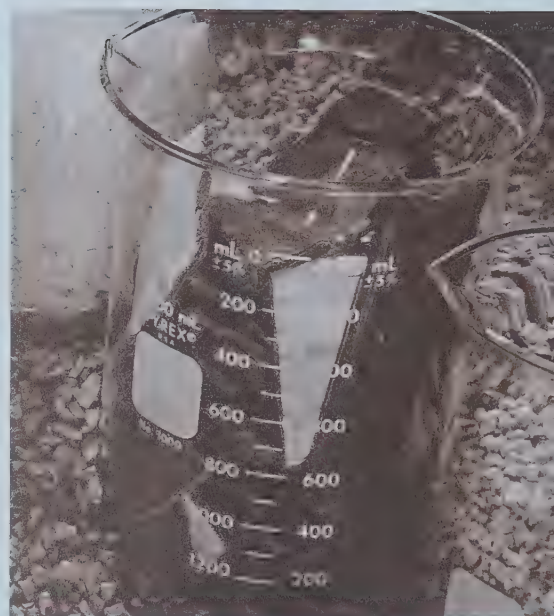
Our strategy of adding value to industrial by-product streams through resource recovery has sustained us through very turbulent times. We are a market leader in the processing of distilled solvents and engineered fuels from industrial by-products. We have commercialized innovative, proprietary technology to achieve on-site waste minimization and resource recovery. We have forged strong alliances with major industry sectors. Through technology leadership, aggressive marketing and the addition of new customers through strategic acquisitions, the By-Products Recovery Group increased volumes throughout 1996.

Our Traditional Business

Philip is a leader in the production of engineered fuels from solid and liquid industrial by-products. This product provides a lower cost fuel to the cement industry compared to fossil fuels such as coal and oil. In 1996, Philip processed over 40 million gallons of engineered fuels that were specifically designed and blended to meet the proposed Maximum Achievable Control Technology standards of the US Environmental



Dr. Paul Kierkus, Manager, R & D Urethane Applications, BASF and Bob Patzelt, Operations Manager, Polyurethane Recycling, Philip worked closely to commercialize BASF's polyurethane recycling technology for the North American market.



Polyurethane Recycling

Approximately 3 billion pounds of polyurethanes are produced each year in North America. Rigid polyurethane is used in the automotive industry to produce moulded parts that range from bumpers to interior panels. Without an effective way to recycle these parts, scrap polyurethane ultimately ends up in landfills.

BASF has chosen Philip as its operator to recycle polyurethane for the North America market.

Using BASF's patented process, polyurethane is broken down into its basic chemical building blocks. Polyols are recovered and used in the same process as virgin polyols to produce new polyurethane products. Philip will source the polyurethane scrap and recycle the material, which will be sold to BASF for further processing and sale to manufacturers of various products.

BASF's technology has successfully operated in Europe for a number of years, but the Philip plant currently under construction will be the first in North America. Located at Philip's Detroit facilities, the plant will be capable of initially recycling 10 million pounds of polyurethane annually.

Protection Agency. Meeting air quality standards and providing a lower cost alternative to both the generator and the end-user of these materials, this process will continue to outperform traditional incineration, treatment or landfilling alternatives.

Solvents are used by virtually every manufacturing industry as a cleaning agent. In 1996, the By-Products Recovery Group recycled over 8 million gallons of spent solvents, distilling the solvents to remove impurities and either returning them to the generator or packaging for resale. We also expanded our solvent reclamation and fuel blending services to the southeastern United States and commissioned distillation services in the Northwest. We will continue to grow our business in under-serviced geographic markets.

New Technologies

With growing demand for on-site waste minimization and improved industrial efficiencies, we expect emerging technology will lead the By-Products Recovery Group to deliver specialized and typically higher margin resource recovery services.

Our revolutionary patented technology to capture paint overspray in industrial paint spray booths is presently installed at over twenty automotive related manufacturing plants. The process continues to generate strong interest not only in North America but also globally to support our clients' international operations. In 1996, we completed the expansion of our processing facility in Detroit to support new contracts and a second processing plant will be commissioned in 1997. These two facilities will more than double our processing capacity to meet growing market demand.

We have also been selected by BASF, one of the world's largest chemical companies, to be their North American operator to recycle rigid polyurethane scrap. The first of its type in North America, the new Detroit facility will use a reaction process to break down polyurethane into its basic chemical building blocks for reuse. The facility will be commissioned in 1997 and will have the initial capacity to recycle 10 million pounds of polyurethane annually.

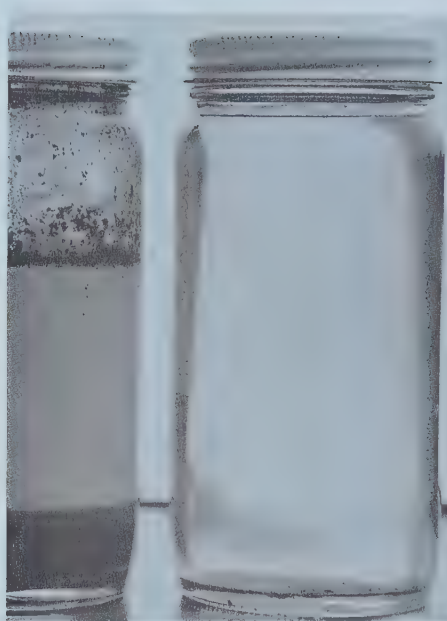
Our business is changing, driven by niche opportunities in the marketplace. Customers are looking for non-disposal options that reduce their costs without adversely impacting operations. Through the competitive advantages provided by our waste minimization and recovery technologies, we are well positioned to be a significant player in this market. We are continuing to explore new recovery technologies that will expand our services to existing clients and support new market growth.



EPOC

In 1996, Philip obtained six new contracts for our revolutionary paint overspray recovery system, EPOC. We expanded our paint recycling facility in Detroit to keep pace with market demand. From this location, Philip manages contracts at over 20 parts manufacturing and automotive assembly plants.

In 1997, the expansion of EPOC will be supported by the establishment of a second processing plant.



Paint Overspray Recovery

In the past, paint overspray ended up as sludge, a significant waste stream and production bottleneck in automotive manufacturing. Through the EPOC process, residual paint is captured in a solvent based emulsion and then transported for processing at Philip's Detroit facility. The active EPOC ingredient and paint residues and solvents are recovered for reuse. The result is improved paint booth efficiency, leading to decreased paint usage and significant cost savings, as well as the diversion of material from landfills. The success of the EPOC technology has led to new opportunities to support our clients' existing and new automotive manufacturing operations.



Taro Landfill

In 1996, Philip received approval to expand its solid non-hazardous industrial landfill near Hamilton, Ontario. This facility, with a total capacity of 11 million tons, is licensed to receive up to 825,000 tons of material annually. The landfill supports Philip's recycling operations as a secure disposal site for residuals that cannot be recycled and is an important component of Philip's single vendor approach to servicing the region's large integrated steel mills.

Environmental Services

In the early 1900's streets, homes and industries were lit with manufactured gas made from coal. These gas plants have long since been abandoned but the contamination produced from the coal tar and other hazardous organic compounds is still with us.

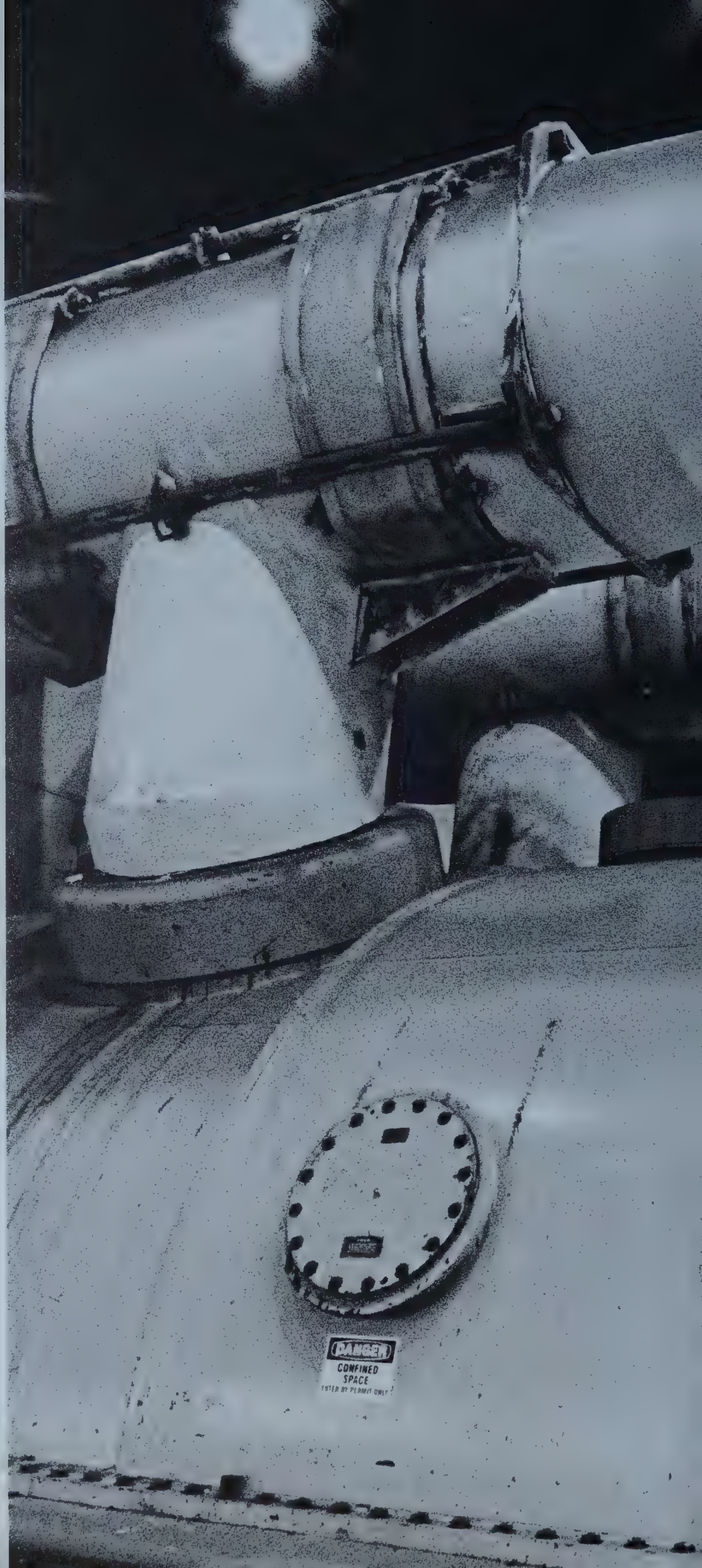
In 1996, Illinois Power awarded Philip the contract for complete on-site management of the remediation of 24 of its contaminated gas plant sites. Philip provides initial engineering and risk assessment through to decommissioning and site remediation.

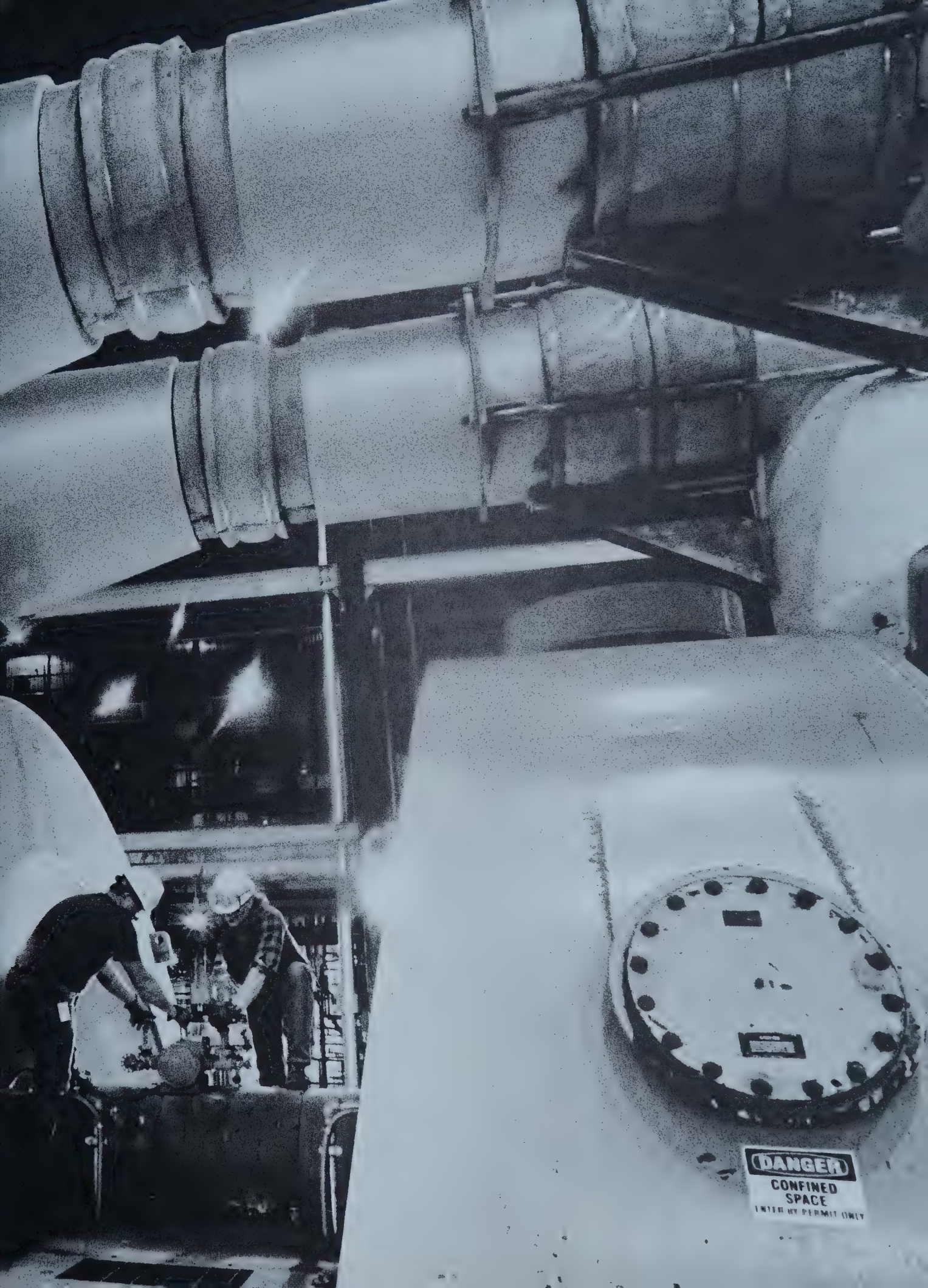
Contaminated materials are stabilized prior to being transported to Illinois Power's Baldwin Thermal Treatment facility.

Illinois Power's use of a single vendor has led to an innovative agreement with Philip.

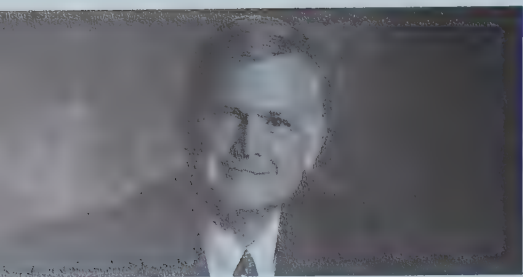
The 10 year contract, which will generate over US\$50 million in revenue, enables work plans and budgets to be developed collectively, with both partners sharing equally in the cost savings through an integrated approach to project management.

At Illinois Power's Baldwin Thermal Treatment facility





DANGER
CONFINED
SPACE
ENTER BY PERMIT ONLY

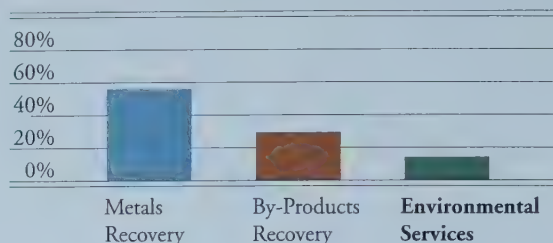


Jerry Penland, President,
Environmental Services
Group

"We are no longer just in the consulting business. Environmental Services has become a full service provider; from demolition and investment recovery to industrial cleaning, maintenance and total resource management.

"Industries are consolidating suppliers, inviting on-site services and investing in resource recovery. We are targetting industry sectors that have high waste minimization opportunities and we are prepared to share the risks and opportunities through performance-based contracts."

DIVERSIFICATION OF 1996 REVENUE BASE (Percent)*



* From Continuing Operations

Throughout 1996, the Environmental Services Group redefined its focus and broadened its service mix to support Philip's integrated approach to the industrial services market. We provide turnkey demolition, remediation, fabrication, cleaning and maintenance services, supported by Philip's extensive by-products and metals recovery capabilities.

We have channelled the Group's consulting and technical services into Strategic Resource Management (SRM), providing our clients with new opportunities to create economic growth by reducing waste generation at the source and through more effective materials management. Through our information management services, we assist clients in tracking raw materials through their manufacturing process to final waste generation. The resulting data establishes total costs associated with waste generation, including the cost of raw materials, processing costs and lost production through to end disposal. SRM provides cost reductions by improving the utilization of costly in-plant resources and creates opportunities to cross-sell Philip's other by-products and metals recovery operations.

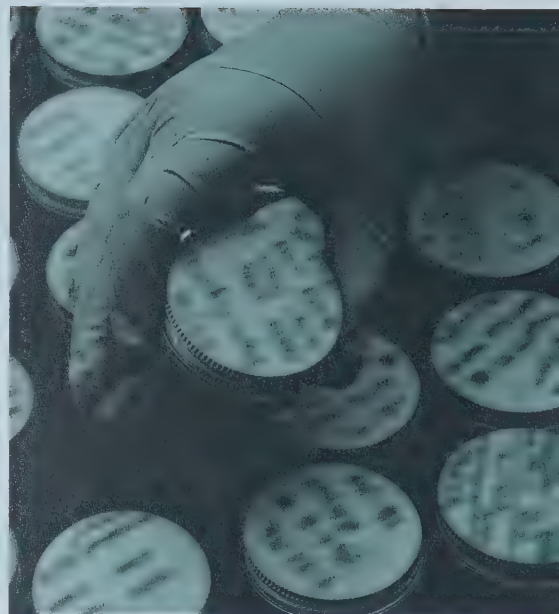
We have redirected our remediation services away from lower margin "dig and haul" solutions to applied technologies which are more efficient. Increased activity on state level Superfund clean-up and industrial redevelopment projects, combined with regulatory reform to establish achievable standards for site clean-up, is driving growth in our remediation business. We have established a partnership with Royal LePage Commercial, one of Canada's leading real estate companies, to provide



Asbestos and Lead Abatement

Philip is a strong player in the North American asbestos and lead abatement market. These services complement the expansion of Philip's demolition business into the USA, as most major demolition contracts also require asbestos abatement.

The acquisition of the assets and business of IAM Environmental of Houston, Texas, gave Philip a base on the Gulf Coast from which to provide integrated decommissioning, industrial and by-products recovery services to the heavy concentration of petrochemical companies in this region.



Analytical Services

Philip operates a network of environmental laboratories in Canada, from which we service a North American client base.

Samples are shipped, analyzed and returned to the client in as little as 24 hours from anywhere in North America. We are co-locating analytical service centres within other Philip operations to support the rapid growth in our US business. Supported by our extensive air and dioxin analysis capabilities, we have recently signed an agreement with a major Japanese laboratory to analyze air samples which we will receive from Japan.

their clients with fixed price contracts for the remediation of commercial and industrial sites. A similar program is being developed for the US market.

In early 1997, we acquired RMF Global to expand our industrial maintenance and mechanical contracting capabilities and our client base in the automotive, petrochemical, railroad and utilities sectors. RMF specializes in all aspects of industrial services including demolition, construction, fabrication, cleaning and maintenance services. For the past ten years, through its 'Right Team' program, RMF has provided full service paint shop maintenance and cleaning services at the Auto Alliance International assembly plant in Flat Rock, Michigan, a joint venture between Ford and Mazda. Combining the 'Right Team' services with our EPOC paint overspray recovery process, Philip can provide fully integrated paint shop cleaning, maintenance and by-products recovery services.

We have acquired significant new business through integrating and cross-selling our services with Philip's other operations. For example, by working closely with our By-Products Recovery Group, we were awarded a comprehensive waste management contract with Canadian National (CN), the sixth largest railroad in North America. The Environmental Services Group is conducting environmental audits, supported by Philip's analytical services and database management systems, at CN's operations throughout North America. The By-Products Recovery Group is managing industrial wastes generated at these sites such as spent solvents, oils and filters and is providing industrial cleaning services. Together, we are able to respond to our clients' demands for vendor reduction by packaging our environmental and industrial services.

Environmental service projects range from demolition contracts at a large integrated steel mill and an automotive assembly plant, through to total on-site management of the environmental program at a large pulp and paper mill, including regulatory compliance, remediation and by-product management. We will continue to cross-sell our industrial, by-products, and metals recovery services to provide one-stop shopping for our clients.



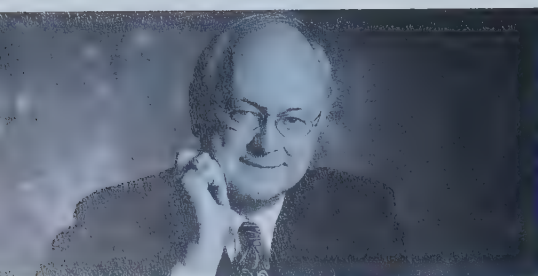
Demolition, Decommissioning & Investment Recovery

At a retail warehouse north of Toronto, Ontario, Philip demolished a 175 foot stack. Using specialized equipment to remove bricks from the base, the stack was 'felled' within centimeters of its target.

Combining demolition with remediation, abatement and investment recovery services provides clients

with turnkey solutions for decommissioning of contaminated properties.

With our ability to provide 'investment recovery', which includes the recovery of construction materials for reuse and sale of abandoned machinery and equipment, we can achieve significant diversion from landfill in addition to substantial savings for our clients.



Marvin D. Boughton,
Executive Vice-President
& Chief Financial Officer

Fiscal 1996 was a watershed year for Philip Environmental. Disposing of the municipal and commercial solid waste business and finding an equity partner for our utilities management business, freed the Company to pursue its stated goal of becoming North America's premier resource recovery and industrial services company. Tuck in acquisitions of businesses including Cousins, Reclaimers and the analytical business formerly owned by Zenon augmented our core operations in metals recovery and environmental services. Strategic acquisitions that occurred later in the year like Luntz, Intsel and the aluminum alloys Alcan plant added depth to the services that we offer to our customers, and significantly expanded our presence in the US market. Further expansion of our geographic base occurred with the acquisition of businesses like Allied, RMF and Warrenton which were concluded in the first quarter of 1997.

I invite you to review the 1996 consolidated financial information contained on the following pages. If you require further information on the Company, please feel free to contact our investor relations department at the corporate office in Hamilton, Ontario.

FINANCIAL INFORMATION

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion reviews the Company's operations for each of the years in the three year period ended December 31, 1996 after giving retroactive effect to discontinued operations, and sets forth management's discussion and analysis of these results. This material should be read in conjunction with the Company's Consolidated Financial Statements and the notes thereto.

INTRODUCTION

The Company supplies integrated resource recovery and industrial services through a network of metals recovery, by-products recovery, and environmental services operations throughout North America. The Company also provides water and wastewater management services principally in Ontario, Canada and Texas. The Company's metals recovery operations apply customized process technologies to recover metals from industrial by-products, focusing on non-ferrous operations which recover copper and aluminum from wire and cable scrap and ferrous operations which recover iron units from steel scrap and other materials. The Company's by-products recovery operations apply customized process technologies to recover or create usable products from liquid and solid industrial by-products (primarily hazardous and non-hazardous chemical waste). The Company's environmental services operations provide a broad range of remediation and technical services, including strategic resource management; site remediation; decommissioning and investment recovery; and other environmental services, including analytical and emergency response services.

The Company has, through acquisitions, as well as internal growth, substantially increased the revenue from its metals recovery, by-products recovery and environmental services operations. The most significant of the Company's acquisitions occurred in the fall of 1993, and during 1996. In 1993, the Company acquired Waxman Resources Inc. ("Waxman"), Nortru, Inc. ("Nortru"), and Burlington Environmental Inc. ("Burlington"). These business acquisitions formed the nucleus of the Company's three primary service groups. In

1996, the Company acquired eleven additional businesses including Luntz Corporation ("Luntz") of Canton, Ohio, the aluminum alloy processing assets formerly owned by Alcan in Guelph, Ontario ("Alloys") and Intsel Southwest Limited Partnership ("Intsel") of Houston, Texas. Luntz is a provider of ferrous scrap and mill services in the USA. Alloys expands the Company's ability to recover and process aluminum and aluminum alloy products. Intsel is a distributor of a broad range of heavy carbon steel products. Since the acquisition of Waxman in 1993, the Company has been able to renew many contracts with existing customers and enter into contracts with new customers for the processing of copper, aluminum and ferrous materials. This, together with the addition of Luntz, Alloys and Intsel in 1996, has increased the annual revenue of the Company's metals recovery business from approximately \$50 million in 1993 to approximately \$450 million in 1996.

In 1996, the Company disposed of its municipal and commercial solid waste business in Ontario, Quebec and Michigan. The Company's Consolidated Financial Statements therefore disclose the results of the Company's municipal and commercial solid waste business as "discontinued operations". Management's discussion and analysis of financial condition and results of operations are therefore after giving retroactive effect to discontinued operations as discussed in note 4 to the Consolidated Financial Statements.

The Company has made the shift in its business focus away from municipal and commercial solid waste operations because the cost of expanding each of the metals recovery, by-products recovery and environmental services businesses, through acquisitions and/or on-going capital requirements, is lower than that required for expanding the solid waste business. Therefore, even though the gross profit margin in these businesses is lower than those in the solid waste business, as reflected by the Company's decline in consolidated gross profit margin from continuing operations from 22.4% in 1994 to 22.1% in 1995 and 20.5% in 1996, the Company's overall gross profit has increased

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Continued)

significantly. In addition, the costs of regulatory compliance associated with the metals recovery business are less than those of the municipal and commercial solid waste business.

In addition, in 1996 the Company's acquisition program targetted specific businesses which enhanced the Company's ability to serve its metals recovery clients. In the future, the Company expects to grow and/or acquire businesses which provide a broad range of industrial services in order to more appropriately balance the mix of metals recovery and industrial services offered by the Company.

The Company earns revenue from the sale of recovered commodities and from fees charged to customers for by-product transfer and processing, collection and disposal services. The Company receives by-products, and, after processing, disposes of the residuals at a cost lower than the fees charged to its customers. Other sources of revenue include fees charged for environmental consulting and engineering and other services, and revenue from the sale of steel products.

In its metals recovery operations, the Company is exposed to commodity price risk during the period that it has title to products that are held in inventory for processing and/or resale. The Company hedges a significant percentage of this commodity price risk by matching purchases of recoverable materials with offsetting future sales.

Notwithstanding the fact that the Company reports its financial results in Canadian dollars, approximately 47% of the Company's 1996 consolidated revenue of \$803 million was generated by the Company's operations located in the United States and approximately 74% of the Company's consolidated revenue was contracted for in US dollars. Accordingly, fluctuations in the exchange rate between the United States dollar and the Canadian dollar could have a material effect on the Company's reported results. The Company borrows substantial sums of money in US currency (December 31, 1996 - US \$150,794; December 31, 1995 - US \$129,875, including the Company's 6% convertible subordinated debentures outstanding at that date) which provides, in part, a natural hedge to

the Company's foreign currency exposure. To date, the Company has not engaged in exchange rate hedging activities with respect to revenue and expense transactions.

The resource recovery and industrial services business is highly competitive. Price competition in the metals and by-products recovery businesses is significant. Competition comes directly from companies in the recovery and recycling business and indirectly from waste disposal companies that charge competitive rates for disposal of waste products. The Company's environmental services business is sensitive to a broad range of competition as customers seek out those environmental management and consulting engineering firms with the reputation of having the best solution for environmental problems. Competition could have a material adverse effect on the Company's results from operations and financial condition by depressing prices or by causing waste to be diverted to competitors. In addition, such competition could materially affect the Company's ability to service its customers profitably, to attract new customers and to retain such customers upon the expiration of existing contracts.

Operating expenses include direct and indirect labour and the related taxes and benefits, fuel, maintenance and repairs of equipment and facilities, depreciation, property taxes, and accruals for future closure costs.

Selling, general and administrative expenses include management salaries, clerical and administrative costs, professional services, facility rentals and insurance costs, as well as costs related to the Company's marketing and sales force.

**IMPACT OF INFLATION, ECONOMIC CONDITIONS
AND SEASONALITY**

As a result of weather related circumstances during the winter months, and a general economic slowdown over the Christmas holiday period, the Company experiences lower levels of activity in December and during the first quarter of its fiscal year. Therefore, the first quarter results may not be indicative of the results that will be achieved during the entire year.

IMPACT OF POLITICAL AND SOCIAL CLIMATE

The Company believes that public awareness of the need to handle and dispose of by-product waste materials properly, and increasingly strict regulatory controls affecting the treatment and handling of such waste, affect the resource recovery and industrial services industry, by increasing the demand for the

Company's services and reliance on experienced and licensed operators of transfer, processing and disposal facilities. In addition, since the Company places heavy emphasis on reuse and recycling as a part of its overall operating strategy, the Company is benefiting and expects to continue to benefit from the increasing use of recycled products as raw materials.

RESULTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 1996, 1995 AND 1994

The following table presents, for the periods indicated, the percentage relationship which the various items in the Consolidated Statements of Earnings bear to the consolidated revenue from continuing operations:

<i>Years Ended December 31,</i>	1996	1995	1994
Revenue	100.0%	100.0%	100.0%
Operating expenses	79.5	77.9	77.6
Gross profit	20.5	22.1	22.4
Expenses			
Selling, general and administrative	10.2	10.7	10.9
Interest	3.0	4.3	4.4
Amortization of goodwill	1.0	1.1	1.2
Other	(0.6)	(0.5)	(0.4)
Earnings from continuing operations	6.9	6.5	6.3
Income taxes	1.9	1.9	1.8
Net earnings from continuing operations	5.0	4.6	4.5
Discontinued operations (net of tax)	(0.1)	0.4	0.5
Net earnings	4.9%	5.0%	5.0%

The Company's operations have expanded and changed significantly during the three year period ended December 31, 1996, and therefore the following comparison may not be a meaningful indicator of the future growth or performance of the

Company. The acquisitions made by the Company in the fall of 1993 and during 1996 played a significant role in the Company's general business strategy to expand both the revenue base and the geographic and service diversity of the Company.

REVENUE

The following table sets forth, for the periods indicated, revenue figures from continuing operations for the Company and its subsidiaries by service category, as well as the percentage of total revenue:

<i>Years Ended December 31,</i> <i>(in thousands)</i>	1996		1995		1994	
Metals Recovery	\$452,385	56.4%	\$308,785	47.7%	\$217,528	44.4%
By-Products Recovery	235,567	29.4%	234,894	36.2%	198,882	40.6%
Environmental Services	112,726	14.0%	104,632	16.1%	73,330	15.0%
Utilities Management	1,812	0.2%	—	—	—	—
Total	\$802,490	100.0%	\$648,311	100.0%	\$489,740	100.0%

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Continued)

Consolidated revenue in 1996 of \$802.5 million represented an increase of \$154.2 million or 23.8% over 1995. The increase was attributable to internal growth of approximately \$3.2 million and approximately \$151.0 million from acquisitions. Consolidated revenue in 1995 of \$648.3 million represented an increase of \$158.6 million or 32.4% over 1994. The increase was attributable to internal growth in revenue of approximately \$105.6 million and \$53.0 million from acquisitions.

The increase in metals recovery revenue in 1996 was \$143.6 million or 46.5%. The acquisition of four new businesses in the metals recovery group contributed approximately \$127.8 million of the increase. The remainder of the increase, or approximately \$15.8 million, came from new contracts or the renewal of existing contracts for the receipt and processing of additional materials.

The increase in metals recovery revenue in 1995 was \$91.3 million or 42.0%. The acquisition of major new contracts for the receipt and processing of additional materials added approximately \$66.0 million to 1995 revenue, by increasing the volume of copper and brass materials available for processing and sale. Approximately \$10.0 million of the increased revenue was attributable to a 25% increase in production capacity which resulted from the Company opening a wire and cable processing plant in the United States in June 1995. Lastly, an increase in the volume of ferrous scrap sales produced \$9.4 million in additional 1995 revenue.

By-products recovery revenue increased by approximately \$700,000 in 1996, or 0.3% over 1995. In general, the volume of material processed by the by-products recovery group in 1996 increased. However, pricing levels for services rendered by this group continued to be depressed throughout 1996, offsetting the increase in revenue which would have resulted from processing larger volumes of material. In addition, a delay in the licensing approval process for the continued use of the Taro landfill site resulted in a decrease in revenue of approximately \$13 million from 1995 levels. The approval was received in the fourth quarter of 1996.

The increase in by-products recovery revenue in 1995 of \$36.0 million was attributable in part to \$31.0 million in revenue generated by three new by-products recovery businesses acquired in 1995 which were consolidated with the revenue of the Company for the first time. The remainder of the increase was attributable to the full year's consolidation of businesses acquired in the prior year and the increased volume of materials handled by this group in 1995. Pricing levels for services rendered by this group were low throughout 1995 reflecting, in part, the over-capacity of processing facilities in the chemical waste disposal market throughout North America.

The increase in environmental services revenue in 1996 was \$8.1 million or 7.7%. This increase is the net result of additional revenue from two businesses acquired by the environmental services group in 1996, amounting to \$23.2 million, offset by a decline in environmental consulting revenue amounting to \$15.1 million, in part as a result of closing non-contributing offices in the USA.

The increase in environmental services revenue in 1995 of \$31.3 million or 42.7% was attributable to \$21.0 million in additional revenue generated by the Delsan group, a company acquired in late 1994, and to a general increase in the level of other business services provided by this group.

In October 1996, the Company entered into an agreement with the Ontario Teachers' Pension Plan Board ("Teachers"), whereby Teachers' acquired an equity interest in Philip Utilities Management Corporation ("PUMC") (see note 13 to the Consolidated Financial Statements). Effective from November 1, 1996, the Company's investment in PUMC has been recognized using the proportionate consolidation method.

Revenue by geographic segment is as follows:

<i>Years Ended December 31,</i>			
<i>(in thousands)</i>	1996	1995	1994
United States	\$373,453	\$213,454	\$166,744
Canada	\$429,037	\$434,857	\$322,996

The increase in revenue generated in the United States is a direct result of the Company acquiring more businesses located in the USA (six of the eleven businesses acquired in 1996 and three of the six businesses acquired in 1995 - see note 3 to the Consolidated Financial Statements) and the continuing expansion of business by subsidiary companies located in the USA.

OPERATING EXPENSES AND GROSS PROFIT

Operating expenses in 1996 were \$637.7 million, an increase of \$132.4 million or 26.2% over 1995. These increased costs result from the increased level of business activity in 1996 and from acquisitions completed during the year. The Company's gross profit increased in 1996 by \$21.8 million or 15.2%. However, the Company's gross profit margin in 1996 decreased to 20.5% of revenue compared to 22.1% in 1995. The decrease in gross profit margin is a direct result of lower gross profit margins in each of the by-products recovery, metals recovery and environmental services during 1996 and a further shift in the Company's business mix to include a higher percentage of metals recovery business which typically generates a lower gross profit margin.

Operating expenses in 1995 were \$505.3 million, an increase of \$125.2 million or 32.9% over 1994. These increased costs result from the increased level of business activity in 1995, from acquisitions completed in that year and the consolidation for a full year of acquisitions completed in 1994, as well as internal growth. The Company's gross profit increased in 1995 by \$33.4 million, or 30.5%. The Company's gross profit margin decreased from 22.4% of revenue in 1994 to 22.1% of revenue in 1995.

Depreciation and amortization of fixed assets increased by \$5.6 million in 1996 to \$22.9 million, and by \$3.7 million in 1995 to \$17.3 million. These increases were due to acquisitions, to a continued high level of fixed asset additions, and to the full year effect of acquisitions completed by the Company during prior years.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses in 1996 were \$82.0 million, representing an increase of \$12.7 million or 18.4% over 1995. In 1995, these expenses were \$69.3 million, representing an increase of \$16.2 million or 30.5% over 1994. The increase in 1996 and 1995 is in part attributable to the addition of selling and administrative costs of companies acquired during the two years and in part to an increase in the general sales staff as well as a general increase in costs over the base year 1994. As a percentage of revenue, selling, general and administrative expenses have decreased to 10.2% in 1996, largely as a result of the increase in revenue.

INTEREST EXPENSE

Aggregate interest expense in 1996, 1995 and 1994 was \$24.6 million, \$28.2 million, and \$21.8 million respectively. In May of 1996, the Company issued common shares and used the proceeds to reduce the amount of long-term debt outstanding. In addition, in 1996, all the remaining 6% convertible subordinated debentures were converted into common shares of the Company, further reducing the Company's outstanding debt. Both these factors contributed to a lowering of interest costs in 1996. The increase in 1995 was primarily attributable to the increased level of borrowing to finance the Company's growth by acquisition and fixed asset expansion, together with working capital requirements to support the Company's increased revenue base.

INCOME TAXES

For the year ended December 31, 1996, the effective income tax rate for the Company was approximately 28% as compared to an effective income tax rate of 29% in 1995 and 28% in 1994. This effective income tax rate reflects the Company's significant business in the United States and other jurisdictions where rates are generally lower than income tax rates in Canada.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Continued)

INCOME FROM DISCONTINUED OPERATIONS

Income from discontinued operations of \$6.8 million in 1996, \$2.9 million in 1995 and \$2.5 million in 1994 consists of the net earnings of the Company's municipal and commercial solid waste business (see note 4 to the Consolidated Financial Statements). These operations have been discontinued as a result of the sale of the Company's municipal and commercial solid waste business in 1996.

Interest expense has been allocated to the municipal and commercial solid waste business segment based upon the relationship of the net assets of the solid waste business to the Company's consolidated net assets.

Income from discontinued operations increased in 1996 to \$6.8 million, principally as a result of the Company having been awarded several new contracts for municipal solid waste collection and disposal which commenced January 1, 1996. In 1995, income from discontinued operations was \$2.9 million, compared to the \$2.5 million earned for the year ended December 31, 1994.

LIQUIDITY

At December 31, 1996, the Company's working capital was \$347.5 million, representing an increase of \$240.9 million over 1995. Inventory for resale is a significant component of the working capital at December 31, 1996, and increased by \$148.6 million over December 31, 1995. Of this increase, \$92.0 million was added through companies acquired during the year, \$12.7 million was added by reason of new plant facilities opened during the year, and the remainder resulted from inventories acquired in connection with new contracts or renewed contracts entered into by the metals recovery group. In addition, at December 31, 1996, accounts receivable increased by \$135.7 million, due in part to accounts receivable acquired as part of new business combinations amounting to \$94.0 million. The remainder of the increase in accounts receivable relates to the increase in business conducted by the metals recovery group.

At December 31, 1995, the Company's working

capital was \$106.6 million representing an increase of \$18.3 million, or 20.7% over 1994. A significant component of working capital at December 31, 1995 consisted of approximately \$94.0 million in non-ferrous inventory to support the Company's metals recovery operations.

Positive cash flow and a strong working capital position continue to be of critical importance to the liquidity of the Company.

In September 1996, the Company signed a new four year term loan agreement with a syndicate of banks in Canada and the United States which provides up to US \$550 million in borrowings, subject to compliance with specified availability tests. This credit agreement is guaranteed directly and indirectly by the Company's subsidiaries and is collateralized by a fixed and floating charge on substantially all of the assets of the Company and its wholly-owned subsidiaries. At December 31, 1996, the Company had undrawn credit capacity under this facility of approximately \$395.2 million, net of letters of credit outstanding which amounted to \$18.4 million.

The Company believes that its short and long-term financial requirements can be met by cash flow from operations together with the opportunity to negotiate new credit agreements and/or issue additional common shares of the Company for cash. There can be no assurance however, that such credit agreements or share issuances will be in the amounts required by the Company or on terms which are favourable to the Company.

CAPITAL EXPENDITURES

Capital expenditures for continuing operations were \$59.8 million in 1996, \$37.0 million in 1995, and \$29.9 million in 1994. The major components of these capital expenditures are categorized as follows:

<i>Years Ended December 31, (in thousands)</i>	1996	1995	1994
Equipment additions			
& replacements	\$42,800	\$28,300	\$17,000
Facilities acquisitions	3,200	3,600	10,000
Landfill	13,800	5,100	2,900

The Company's capital expenditure program for 1997 is expected to be approximately \$75.0 million. This amount includes anticipated expenditures of \$20.0 million in connection with the Company's announced plans to construct a Zinc Iron Plasma Processing ("ZIPP") furnace to process electric arc furnace residuals. Approximately \$5.0 million is expected to be expended on environmental compliance matters relating to facilities operated by the Company. The remaining \$50.0 million in capital expenditures relates to repairs and improvements to existing facilities and equipment or anticipated capital expenditures associated with businesses acquired during fiscal 1996 and the early part of 1997.

The Company expects to fund the \$5.0 million for environmental compliance matters from cash provided by operating activities. The Company has arranged for a separate credit facility to finance the construction of the ZIPP furnace. The remaining \$50.0 million in capital expenditures will only be undertaken if the Company can finance these expenditures. There can be no assurance that such financing will be available on terms acceptable to the Company.

The Company may be required to make expenditures to bring operations or businesses acquired in the future into compliance with applicable laws and regulations. The need for and potential amount of such capital expenditures cannot be determined at the present time as they will depend upon the condition of the facilities and sites to be acquired. The Company does, however, estimate the cost to remediate sites owned and / or used by the Company and accrues for these amounts in its financial statements.

DIFFERENCES BETWEEN CANADIAN AND UNITED STATES ACCOUNTING PRINCIPLES

The Company's consolidated financial statements have been prepared in accordance with accounting principles generally acceptable in Canada, ("Canadian GAAP"). See note 18 to the Consolidated Financial Statements for a discussion of the differences between Canadian GAAP and US generally accepted accounting principles.

MANAGEMENT'S REPORT TO SHAREHOLDERS

The accompanying consolidated financial statements of Philip Environmental Inc. and all other information presented in this annual report are the responsibility of management. The financial statements have been prepared in accordance with accounting principles generally accepted in Canada and include some amounts that are based on management's best estimates. Financial and operating information presented in this report is consistent with the information contained in the financial statements.

Management of the Company develops and maintains systems of internal controls to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and that financial records can be relied upon for the preparation of financial statements. The Board of Directors, through its audit committee, oversees this management responsibility. The audit committee, comprised of non-employee directors, meets periodically with management and the external auditors to satisfy itself as to the adequacy of these systems and the effectiveness of the financial reporting process.

The shareholders' auditors, Deloitte & Touche, Chartered Accountants, have full access to all Company financial records as well as to the audit committee. Their report on the accompanying financial statements follows this report.



Allen Fracassi
President & Chief Executive Officer



Marvin D. Boughton
*Executive Vice-President &
Chief Financial Officer*

February 26, 1997

AUDITORS' REPORT TO SHAREHOLDERS

To the Shareholders of Philip Environmental Inc.

We have audited the consolidated balance sheets of Philip Environmental Inc. as at December 31, 1996 and 1995, and the consolidated statements of earnings, retained earnings and changes in financial position for each of the years in the three year period ended December 31, 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Canada. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1996 and 1995 and the results of its operations and the changes in its financial position for each of the years in the three year period ended December 31, 1996 in accordance with accounting principles generally accepted in Canada.

Mississauga, Ontario
February 26, 1997



Deloitte & Touche
Chartered Accountants

CONSOLIDATED BALANCE SHEETS

	December 31	
	1996	1995 (Restated)
<i>(in thousands of Canadian dollars)</i>		
ASSETS		
Current assets		
Cash and equivalents	\$ 8,279	\$ —
Accounts receivable (net of allowance for doubtful accounts of \$8,092; 1995 - \$5,528)	273,865	138,180
Inventory for resale	248,055	99,442
Other current assets (Note 5)	61,219	71,322
	591,418	308,944
Fixed assets (Note 6)	348,065	351,849
Goodwill	329,809	292,610
Other assets (Note 7)	75,690	48,722
Due from an officer and director	737	787
	\$ 1,345,719	\$ 1,002,912

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities		
Accounts payable and accrued liabilities	\$ 216,580	\$ 126,531
Interim financing loans payable (Note 3)	—	53,000
Current maturities of long-term debt and loans from related parties (Notes 8 and 17(b))	27,337	22,809
	243,917	202,340
Long-term debt (Note 8)	387,431	249,534
Loans from related parties (Note 17(b))	—	1,128
Deferred income taxes	42,777	31,430
Other liabilities (Note 10)	48,243	58,494
Convertible subordinated debentures (Note 11)	—	147,884
Contingencies (Note 19)		
Shareholders' equity (Note 12)	623,351	312,102
	\$ 1,345,719	\$ 1,002,912

The accompanying notes are an integral part of these financial statements.

Signed on behalf of the Board of Directors:



Derrick Rolfe
Director



Allen Fracassi
Director

CONSOLIDATED STATEMENTS OF EARNINGS

	Years Ended December 31		
	1996	1995	1994
<i>(in thousands of Canadian dollars except per share amounts)</i>		(Restated)	(Restated)
Revenue	\$802,490	\$ 648,311	\$ 489,740
Operating expenses	637,708	505,281	380,134
Gross profit	164,782	143,030	109,606
Expenses			
Selling, general and administrative	82,043	69,309	53,114
Interest — short-term	1,180	2,089	2,355
— long-term	23,418	26,098	19,395
Amortization of goodwill	7,730	7,052	5,971
Other income and expense - net	(4,782)	(3,689)	(2,122)
	109,589	100,859	78,713
Earnings from continuing operations before tax	55,193	42,171	30,893
Income taxes (Note 15)	15,180	12,354	8,769
Earnings from continuing operations	40,013	29,817	22,124
Discontinued operations (net of tax) (Note 4)	(1,005)	2,894	2,502
Net earnings	\$ 39,008	\$ 32,711	\$ 24,626
Basic earnings per share			
Continuing operations	\$ 0.79	\$ 0.80	\$ 0.61
Discontinued operations	\$ (0.02)	\$ 0.08	\$ 0.07
	\$ 0.77	\$ 0.88	\$ 0.68
Fully diluted earnings per share			
Continuing operations	\$ 0.72	\$ 0.68	\$ 0.55
Discontinued operations	\$ (0.01)	\$ 0.05	\$ 0.05
	\$ 0.71	\$ 0.73	\$ 0.60
Weighted average number of common shares outstanding	50,632	37,342	36,209

The accompanying notes are an integral part of these financial statements.

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

	Years Ended December 31		
	1996	1995	1994
<i>(in thousands of Canadian dollars)</i>		(Restated)	(Restated)
Balance, beginning of year as previously reported	\$106,671	\$ 73,960	\$ 49,803
Cumulative effect of change in accounting policy (Note 11)	—	—	(469)
Balance, beginning of year as restated	106,671	73,960	49,334
Net earnings	39,008	32,711	24,626
Balance, end of year	\$145,679	\$ 106,671	\$ 73,960

The accompanying notes are an integral part of these financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

Years Ended December 31

<i>(in thousands of Canadian dollars)</i>		1996	1995 (Restated)	1994 (Restated)
Operating Activities				
Net earnings from continuing operations	\$	40,013	\$ 29,817	\$ 22,124
Items included in earnings not affecting cash				
Depreciation and amortization		26,236	18,458	15,383
Amortization of goodwill		7,730	7,052	5,971
Deferred income taxes		19,542	15,542	11,503
Net gain on sale of assets		(2,241)	(1,215)	—
Cash flow from continuing operations		91,280	69,654	54,981
Change in non-cash working capital <i>(Note 14)</i>		(180,518)	(49,818)	(63,308)
Cash provided by (used in) continuing operating activities		(89,238)	19,836	(8,327)
Cash provided by discontinued operating activities		28,830	15,114	21,649
Cash provided by (used in) operating activities		(60,408)	34,950	13,322
Investing Activities				
Proceeds from sale of solid waste operations <i>(Notes 3 & 4)</i>		210,800	—	—
Acquisitions - including acquired cash (bank indebtedness) <i>(Note 3)</i>		(222,440)	(11,727)	(33,997)
Purchase of fixed assets		(59,847)	(37,016)	(29,910)
Other - net		(35,903)	(26,584)	(989)
Cash used in continuing investing activities		(107,390)	(75,327)	(64,896)
Cash used in investing activities of discontinued operations		(17,307)	(55,824)	(18,421)
Cash used in investing activities		(124,697)	(131,151)	(83,317)
Financing Activities				
Proceeds from long-term debt		338,704	52,643	193,177
Principal payments of long-term debt		(255,914)	(11,927)	(108,671)
Conversion of convertible subordinated debentures		(147,884)	—	(170)
Common shares issued		291,869	1,466	9,824
Other <i>(Note 12)</i>		(20,708)	—	(22)
Cash provided by continuing financing activities		206,067	42,182	94,138
Cash provided by (used in) financing activities of discontinued operations		(12,683)	38,215	(1,903)
Net cash provided by financing activities		193,384	80,397	92,235
Net change in cash for the year		8,279	(15,804)	22,240
Cash position, beginning of year		—	15,804	(6,436)
Cash position, end of year	\$	8,279	\$ —	\$ 15,804

Cash is comprised of cash and equivalents net of bank indebtedness

The accompanying notes are an integral part of these financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

Philip Environmental Inc. (the "Company") is an integrated resource recovery and industrial services company, which provides metal recovery and processing services, by-products recovery, and industrial services to major industry sectors throughout North America. These consolidated financial statements include the accounts of the Company and all of its subsidiary companies.

2. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in Canadian dollars using accounting principles generally accepted in Canada ("Canadian GAAP") which, except for the matters as described in note 18, conform in all material respects with accounting principles generally accepted in the United States ("US GAAP").

The preparation of financial statements in conformity with generally accepted accounting principles requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingencies at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from the Company's estimates.

For all periods presented, the Consolidated Financial Statements and Notes to the Consolidated Financial Statements disclose the Company's municipal and commercial solid waste business as discontinued operations, as discussed in note 4.

Revenue recognition

Revenue from by-products recovery operations is recognized upon receipt and acceptance of materials for processing. Treatment, transportation and disposal costs are accrued when the related revenue is recognized.

Revenue from environmental service contracts is recorded using the percentage of completion basis for fixed rate contracts and as the related service is provided for time and material contracts.

Revenue from the sale of recovered commodities and steel products is recognized at the time of shipment. For contracts where the Company brokers materials between two parties, only the commission on the transaction is recorded.

Cash and equivalents

Cash and equivalents consist of cash on deposit and term deposits in money market instruments with maturity dates of less than three months from the date they are acquired.

Inventory

Inventory is recorded at the lower of average purchased cost and net realizable value.

Fixed assets

Fixed assets are stated at cost and are depreciated over their estimated useful lives generally on the following basis: buildings 20 to 40 years straight-line; equipment 5% to 30% straight-line. Landfill sites and improvements thereto are recorded at cost and amortized over the life of the landfill site based on the estimated landfill capacity utilized during the year. Operating costs associated with landfill sites are charged to operations as incurred. Assets under development include the direct cost of land, buildings and equipment acquired for future use together with engineering, legal and other costs incurred before the assets are brought into operation.

The Company periodically reviews the carrying value of its fixed assets to determine whether such values are recoverable. Any resulting write-downs are charged to earnings.

Goodwill

Goodwill represents the excess of the purchase price of businesses acquired over the fair value of the identifiable assets acquired and is amortized over periods not exceeding 40 years. At each balance sheet date management assesses the appropriateness of the goodwill balance based on the undiscounted future cash flow from operating results.

Other Assets

Deferred financing costs are amortized over the life of the related debt instrument. Other intangibles such as non-compete agreements are amortized over periods relating to the terms of the agreements.

Environmental liability

The Company accrues the estimated costs relating to the closure and post-closure monitoring of its landfill sites. The Company charges earnings with these estimated future costs based on engineering estimates over the fill rate of landfill sites. The accrued liability for environmental and closure costs is disclosed in the consolidated balance sheet under other liabilities. Amounts required to dispose of waste materials located at the Company's transfer and processing facilities are included in accounts payable and accrued liabilities.

Interest capitalization

The Company includes, as part of the cost of its fixed assets, all financing costs incurred prior to the asset becoming available for operation, providing the resulting capital cost of the fixed asset does not exceed the net recoverable amount of the asset.

Foreign currency translation

Assets and liabilities denominated in foreign currencies are translated at the exchange rates in effect at the balance sheet date. Gains and losses on translation are reflected in net earnings of the period, except for unrealized foreign currency gains and losses on long-term monetary assets and liabilities which are deferred and amortized over the remaining lives of the related items on a straight-line basis, unless the item has been designated as a hedge of the net investment in self-sustaining foreign operations, in which case the translation gains and losses are included in the cumulative foreign currency translation adjustment.

The assets and liabilities denominated in a foreign currency for foreign operations, all of which are self-sustaining, are translated at exchange rates in effect at the balance sheet date. The resulting gains and losses are accumulated in a separate component of shareholders' equity. Revenue and expense items are translated at average exchange rates prevailing during the period.

Financial instruments

The Company's accounts receivable and long-term debt constitute financial instruments. The Company's accounts receivable approximated their fair value as at December 31, 1996 and 1995. Concentration of credit risk in accounts receivable is limited, due to the large number of customers the Company services. The Company performs ongoing credit evaluations of its customers, but does not require collateral to support customer accounts receivable. The Company establishes an allowance for doubtful accounts based on the credit risk applicable to particular customers, historical and other information.

3. ACQUISITIONS AND DIVESTITURES *(in thousands)*

During 1996, the Company acquired eleven businesses, including Intsel Southwest Limited Partnership ("Intsel") and Luntz Corporation ("Luntz"). Intsel is a distributor of a broad range of heavy carbon steel products based in Houston, Texas. Luntz, based in Canton, Ohio, provides ferrous scrap and mill services in the USA. During 1995, six businesses were acquired and during 1994, two businesses were acquired.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

3. ACQUISITIONS AND DIVESTITURES *(continued)*

All business combinations have been accounted for using the purchase method of accounting and are summarized below:

	1996				1995	1994
	Intsel	Luntz	Other	Total		
Purchase consideration						
Cash	\$ 84,020	\$ 2,473	\$ 62,595	\$ 149,088	\$ 2,565	\$ 6,650
Company's common shares	—	27,200	13,000	40,200	1,700	8,500
Deferred payments and long-term debt	—	24,480	5,940	30,420	6,140	17,000
Acquisition costs and accruals	270	791	4,202	5,263	944	116
	\$ 84,290	\$ 54,944	\$ 85,737	\$ 224,971	\$ 11,349	\$ 32,266
Fair value of net assets acquired						
Cash (bank indebtedness)	\$ 2,709	\$ —	\$ (178)	\$ 2,531	\$ (378)	\$ (1,731)
Long-term debt	—	(12,593)	(7,134)	(19,727)	(338)	(3,799)
Assets, excluding cash & intangibles	68,036	93,070	70,577	231,683	19,358	26,499
Liabilities	(24,889)	(40,678)	(20,366)	(85,933)	(18,441)	(13,516)
Goodwill	37,066	12,425	39,469	88,960	10,308	23,313
Other intangibles	1,368	2,720	3,369	7,457	840	1,500
	\$ 84,290	\$ 54,944	\$ 85,737	\$ 224,971	\$ 11,349	\$ 32,266

The following table summarizes the unaudited consolidated pro-forma results of operations, assuming the 1996 acquisitions of Luntz and Intsel had occurred at the beginning of 1995. This information does not purport to be indicative of the results of the operations that actually would have resulted if the acquisitions had occurred on January 1, 1995.

<i>Years Ended December 31</i> <i>(unaudited)</i>	1996	1995
Revenue	\$ 1,064,210	\$ 1,028,758
Earnings from continuing operations	\$ 47,637	\$ 38,191
Fully diluted earnings per share from continuing operations	\$ 0.83	\$ 0.74

In July 1995, the Company acquired the 30% minority interest in Intersan Inc. ("Intersan") not previously owned by the Company for \$40,000.

The Company arranged interim financing (the "Interim Financing") to acquire the 30% minority interest and to repay a \$13,000 advance from the former minority shareholder. The Interim Financing bore interest at a rate of 10% per annum and was secured by the assets of Intersan.

In November 1995, the Company reached an agreement to sell the Greater Montreal Area solid waste collection and transfer business of Intersan (the "Intersan Business") for \$43,250. As part of the sale of the Intersan Business, the Company entered into a disposal services agreement with the purchaser. The initial consideration for the disposal service agreement amounted to \$10,000 and was recorded as deferred revenue (note 10).

The proceeds from the sale of the Intersan Business, and the disposal services agreement, which amounted to \$53,250, were received in January 1996, and used to repay in full the Interim Financing.

Subsequent to the year end, the Company acquired three additional businesses. RMF Global, Inc. of Toledo, Ohio provides industrial maintenance and mechanical services, remediation, cleaning and

abatement services. Warrenton Resources Inc. of Warrenton, Missouri, and Conversion Resources Inc., of Cleveland, Ohio, two sister companies are processors of non-ferrous metals. Allied Metals Limited ("Allied") is a steel scrap processing and mill services company in the United Kingdom. The total consideration paid for these acquired businesses amounted to approximately \$113,500 and was made up of \$94,700 in cash, \$18,400 in shares of the Company and \$400 in deferred payments to the vendors. All three business combinations will be accounted for using the purchase method of accounting in 1997.

4. DISCONTINUED OPERATIONS *(in thousands)*

In August 1996, the Company sold its municipal and commercial solid waste business (the "Solid Waste Business") for a total consideration of US \$115,000 to USA Waste Services, Inc. ("USA Waste"). The consideration included US \$60,000 in cash, US \$38,000 in unrestricted common shares of USA Waste, and US \$17,000 in restricted common shares of USA Waste (in total, representing less than 2% of USA Waste's voting stock). The unrestricted common shares of USA Waste were sold in September 1996 for US \$39,508, resulting in a gain before tax of US \$1,508 which is included in Other income and expense - net in the Consolidated Statements of Earnings. The restriction on the US \$17,000 common shares of USA Waste was removed in January 1997 and in February 1997, the Company sold these shares for US \$19,800, resulting in a further gain before tax of US \$2,800.

As part of the sale of the Solid Waste Business, the Company entered into a five year disposal services agreement with the purchaser at preferential tipping rates to utilize disposal capacity at two of the landfills which were sold. No value was assigned to this agreement in the calculation of the loss which resulted on the sale of the Solid Waste Business. The value of this agreement, estimated to be US \$3,000 on a discounted basis, will be recognized as a reduction in future disposal costs as capacity at the landfills is utilized.

The sale of the Solid Waste Business in 1996 included the remaining portion of Intersan, and the disposal services agreement, as described in note 3.

Revenue of the Solid Waste Business, net of intercompany revenue, was \$51,962, \$83,850 and \$80,573 for the fiscal years ended December 31, 1996, 1995 and 1994, respectively. Income from discontinued operations in the Consolidated Statements of Earnings is presented net of allocated interest expense of \$5,133, \$7,000 and \$4,500 and net of applicable income taxes of \$4,394, \$2,363 and \$2,218 for the fiscal years ended December 31, 1996, 1995 and 1994, respectively. Interest was allocated based upon the relationship of the net assets of the Solid Waste Business to the Company's consolidated net assets.

<i>Years Ended December 31</i>	1996	1995	1994
Loss on sale of Solid Waste Business, net of income taxes recoverable of \$3,607	\$(7,848)	\$ —	\$ —
Income from discontinued operations (net of tax)	6,843	2,894	2,502
Discontinued operations	\$(1,005)	\$ 2,894	\$ 2,502

5. OTHER CURRENT ASSETS *(in thousands)*

	1996	1995
Shares of USA Waste (note 4)	\$ 23,290	\$ —
Parts and supply inventory	10,048	7,361
Deposits on contracts	14,049	4,848
Income taxes (payable) recoverable	1,790	(1,244)
Prepaid expenses	1,660	2,847
Other	10,382	4,260
Proceeds receivable from sale of the Intersan Business and the disposal services agreement (note 3)	—	53,250
	\$ 61,219	\$ 71,322

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

6. FIXED ASSETS (in thousands)

	1996			1995		
	Cost	Accumulated depreciation	Net book value	Cost	Accumulated depreciation	Net book value
Land	\$ 54,835	\$ —	\$ 54,835	\$ 51,798	\$ —	\$ 51,798
Landfill sites	21,279	891	20,388	95,048	12,650	82,398
Buildings	81,336	10,694	70,642	59,836	5,072	54,764
Equipment	254,841	74,102	180,739	177,928	38,728	139,200
Assets under development	21,461	—	21,461	23,689	—	23,689
	\$433,752	\$ 85,687	\$348,065	\$ 408,299	\$ 56,450	\$351,849

7. OTHER ASSETS (in thousands)

	1996	1995
Restricted investments (a)	\$ 32,420	\$ 21,205
Deferred financing costs	15,188	8,735
Other	28,082	18,782
	\$ 75,690	\$ 48,722

(a) These restricted investments support the Company's self-insurance program and are invested and managed by the Company's wholly-owned insurance subsidiary.

8. LONG-TERM DEBT (in thousands)

	1996	1995
Bank term loan (including US \$150,794 in 1996; US \$9,950 in 1995)(a)	\$ 339,889	\$ 219,846
Bank term loan (b)	—	13,900
Loans (including US \$767 in 1996; US \$1,122 in 1995) collateralized by certain assets of subsidiaries of the Company having a net book value of \$11,947 bearing interest at a weighted average fixed rate of 5.7 % (1995 – 9.21%) maturing at various dates up to 2002	7,089	1,920
Loans (including US \$3,608 in 1996; US \$615 in 1995) collateralized by certain assets of subsidiaries of the Company having a net book value of \$16,565 bearing interest at prime plus a weighted average floating rate of 1.87% (1995 – 1.14%) maturing at various dates up to 2002	7,508	4,287
Loans (including US \$25,625), unsecured, bearing interest at prime plus a weighted average floating rate of 3.37% maturing at various dates up to 2001	35,698	—
Obligations under capital leases on equipment bearing interest at rates varying from 6% to 12% maturing at various dates to 2002	19,841	16,336
Other	3,611	12,111
	413,636	268,400
Less current maturities of long-term debt (c)	26,205	18,866
	\$ 387,431	\$ 249,534

(a) In September 1996, the Company signed a new US \$550 million term loan agreement with a syndicate of Canadian and US lenders which replaced the 1994 revolving term loan agreement and refinanced certain other long-term debt. The new term loan agreement expires in September of 2000, and contains certain restrictive covenants and financial covenants including the following:

- the Company must meet interest ratio coverage tests as well as total debt and secured debt ratio coverage tests
- the Company must maintain a prescribed level of shareholders' equity
- certain acquisitions by the Company must be reviewed by the lenders prior to completion

At December 31, 1996 the Company is in compliance with all of the covenants of the credit agreement.

Borrowings under the credit facility are guaranteed, jointly and severally by the Company's wholly owned subsidiaries and are collateralized by a fixed and floating charge on substantially all of the assets of the Company and its wholly owned subsidiaries. The facility bears interest based on a moving grid. At December 31, 1996, the Company was paying prime rate, which was 4.75%, on these borrowings.

At December 31, 1996, the Company had undrawn credit capacity under this facility of approximately \$395,200, net of outstanding letters of credit which amounted to \$18,400.

(b) Intersan (note 3) had a separate term loan which bore interest at rates varying from prime to prime plus 0.25% and was collateralized by substantially all of the assets of Intersan. This loan was repaid in January of 1996.

(c) The aggregate amount of payments required to meet long-term debt installments in each of the next five years is as follows:

1997	\$ 26,205
1998	6,047
1999	5,192
2000	373,482
2001	2,710

9. FINANCIAL INSTRUMENTS (in thousands)

Derivative financial instruments are used to fix the interest rate on a portion of the Company's floating rate debt, thereby maintaining interest rate risk at an acceptable level. This is accomplished by swapping the Company's floating rate interest obligations, on a notional amount of debt, with commercial banks having a fixed rate interest obligation. As a result the Company is reliant upon the counterparty to fulfill its obligations and provide protection from interest rate fluctuations. This credit risk exposure is controlled by dealing only with counterparties with strong public credit ratings. A summary of these interest rate swap agreements is as follows:

	1996	1995
Notional amount	\$ 260,000	\$ 180,000
Weighted average term to maturity (years)	1.1	1.5
Average interest rate to maturity	6.60%	6.72%

10. OTHER LIABILITIES (in thousands)

	1996	1995
Deferred payments (a)	\$ 16,129	\$ 20,143
Accrued environmental and closure costs	25,819	24,107
Deferred revenue	—	10,000
Other	6,295	4,244
	\$ 48,243	\$ 58,494

(a) Deferred payments relate to acquisitions (see Acquisitions and Divestitures note 3), whereby the former owners of the businesses have agreed to accept part of their payment over future periods of time. All such amounts are non-interest bearing and are unsecured.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

11. CONVERTIBLE SUBORDINATED DEBENTURES

(in thousands except per share amounts)

	1996	1995 <i>(restated)</i>
6% Convertible subordinated debentures	\$ —	\$147,884

In 1993, the Company issued US \$120,000, 6% convertible subordinated debentures due October 15, 2000 unless previously redeemed, with interest payable each April 15 and October 15. The debentures were convertible at the option of the holder into common shares of the Company at any time up to October 15, 2000 at a conversion price of US\$6.25 per common share. In 1994, debentures of US \$125 were converted.

During 1996, all of the remaining 6% convertible subordinated debentures outstanding were converted into common shares of the Company. Notwithstanding the conversion of these debentures, the January 1996 pronouncement from the Canadian Institute of Chartered Accountants ("CICA") referred to as Section 3860 and entitled "Financial Instruments - Disclosure and Presentation" is applicable for the Company's year ended December 31, 1996 and, as required, Section 3860 has been applied retroactively.

Where a financial instrument consists of both a liability and an equity component, Section 3860 requires that each part be reported separately in accordance with guidance provided in the pronouncement. The Company has therefore restated the liability represented by the 6% convertible subordinated debentures. In addition, shareholders' equity has been restated to include the component of the 6% convertible subordinated debentures deemed to be "other paid in capital" under Section 3860 and amounting to \$20,708 at December 31, 1995. Interest expense has been

increased for the years ended December 31, 1996, 1995 and 1994 by \$2,060, \$2,630 and \$2,411, respectively to disclose the restated interest expense, and net earnings have been correspondingly reduced. Basic earnings per share have been restated to reflect the reduced net earnings which result from the application of this pronouncement. Fully diluted earnings per share previously reported by the Company remain unchanged for each of the years ended December 31, 1996, 1995 and 1994 since the number of common shares represented by the 6% convertible subordinated debentures remains unchanged and the interest expense of the related liability regardless of how determined, is eliminated in the computation of fully diluted earnings per share.

12. SHAREHOLDERS' EQUITY

(in thousands except number of shares)

	1996	1995 <i>(restated)</i>
Share capital	\$476,771	\$ 184,901
Other paid in capital (note 11)	—	20,708
Retained earnings	145,679	106,671
Cumulative foreign currency translation adjustment	901	(178)
	\$623,351	\$ 312,102

Share capital consists of:

Authorized

Unlimited number of
common shares

Issued

Common shares
and equivalents

Number	69,876,868	37,453,833
Dollars	\$476,771	\$184,901

The issued share capital of the Company is comprised of the following:

	Common Shares	
	Number	Amount
Balance – December 31, 1994	37,271,522	\$ 183,436
Shares issued in respect of acquisitions during 1995	194,116	1,700
Shares cancelled	(68,404)	(670)
Other	32,985	246
Share options exercised for cash	23,614	189
Balance – December 31, 1995	37,453,833	184,901
Shares issued in respect of acquisitions during 1996	3,600,102	40,200
Shares issued on conversion of convertible subordinated debentures	19,180,000	146,059
Other paid in capital (note 11)	—	20,708
Shares issued for cash	8,625,000	76,065
Share options exercised for cash	953,724	8,365
Other	64,209	473
Balance - December 31, 1996	69,876,868	\$ 476,771

Stock options

Common share options issued and outstanding are as follows:

	Number	\$/Share
Employee stock option plans (a)		
Year of grant		
1992	50,000	8.00 to 10.375
1993	134,000	8.18 to 9.00
1994	842,080	6.75 to 8.00
1995	843,812	7.875 to 9.875
1996	1,210,800	8.50 to 11.90
Issued in conjunction with the acquisition of Philip Environmental Corporation (c)	776,386	7.05 to 8.00
Issued to a director of the Company (b)(c)	200,000	7.35
Total outstanding December 31, 1996	4,057,078	

(a) The Company has allotted and reserved 4,257,149 common shares under its 1991 and 1994 Employee Stock Option Plans. Under the plans,

options may be granted to purchase common shares of the Company at the then current market price. All options currently expire five to ten years from the date of grant. All the options outstanding were issued at the then current market price.

(b) These options were issued in 1991 at a discount to the then current market.

(c) These options expire on November 26, 2000.

13. INVESTMENT IN PHILIP UTILITIES

MANAGEMENT CORPORATION (*in thousands*)

In October 1996, the Company entered into an agreement with the Ontario Teachers' Pension Plan Board ("Teachers"), whereby Teachers' acquired an equity position in Philip Utilities Management Corporation ("PUMC"), a subsidiary of the Company. Under the terms of the agreement, Teachers' invested \$10 million in equity and will purchase \$10 million in subordinated convertible debentures in return for a 30% voting and a 6.4% non-voting interest, respectively, in PUMC. As of December 31, 1996 Teachers' had not purchased any subordinated convertible debentures.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Prior to divesting of its 30% ownership interest in PUMC, the Company consolidated the results of the subsidiary. The Company recorded in income only the net fees earned by PUMC for management services rendered, which were insignificant. The shareholders agreement between Teachers' and the Company provides for joint control of all economic activities of PUMC and therefore, from November 1, 1996, the Company's investment in PUMC has been recognized using the proportionate consolidation method. The disposition of the Company's 30% interest in PUMC resulted in a gain of \$2,241 which is included in Other income and expense - net in the Consolidated Statements of Earnings.

At December 31, 1996, the Company's interest in the financial position of PUMC was as follows:

Current assets	\$ 12,524
Long-term assets	\$ 14,853
Current liabilities	\$ 7,831
Long-term liabilities	\$ 4,388

Financial results of PUMC for the two month period ended December 31, 1996 were as follows:

Revenue	\$ 1,812
Expenses	\$ 1,816
Net loss	\$ (4)

Cash used in operating activities	\$ (83)
Cash provided by financing activities	\$ 74
Cash used in investing activities	\$ (1,493)

14. CHANGE IN NON-CASH WORKING CAPITAL (in thousands)

Years Ended December 31

	1996	1995	1994
Accounts receivable	\$ (51,135)	\$ (27,078)	\$ (18,472)
Inventory for resale	(77,316)	(33,121)	(49,424)
Other	(47,544)	(18,215)	(3,105)
Accounts payable and accrued liabilities	1,155	20,943	12,559
Income taxes	(5,678)	7,653	(4,866)
	\$ (180,518)	\$ (49,818)	\$ (63,308)

15. INCOME TAXES (in thousands)

The Company's income tax provision is comprised of the following:

Years Ended December 31

	1996	1995	1994
Income tax based on the Federal and Provincial effective income tax rates	\$ 24,627	\$ 18,820	\$ 13,697
Increase (decrease) in income taxes resulting from:			
Lower income tax rates in the USA and other jurisdictions	(6,236)	(5,249)	(5,484)
Manufacturing and processing allowances	(5,526)	(3,394)	(1,037)
Non-deductible expenses for income tax purposes, principally goodwill amortization	3,298	3,854	2,825
Utilization of unrecognized loss carryforwards	—	(1,160)	—
Other	(983)	(517)	(1,232)
Income taxes	\$ 15,180	\$ 12,354	\$ 8,769

The allocation between current and deferred income taxes results primarily from the accelerated write-off of expenditures for income tax purposes and certain accounting accruals not currently deductible for income tax purposes, offset by the accounting recognition of loss carryforwards.

16. INTEREST CAPITALIZATION *(in thousands)*

During the years ended December 31, 1996, 1995 and 1994 the Company included \$3,040, \$2,427, and \$747 respectively of financing costs as part of the cost of assets under development.

17. RELATED PARTIES *(in thousands)*

(a) The following transactions were recorded with the directors and officers of the Company:

	1996	1995	1994
Advances from (repayments to) directors	\$(3,943)	\$(18,311)	\$(3,889)
Interest paid to directors	267	1,891	2,040
Unsecured advances to an officer and director – net	(50)	(50)	(37)

(b) Loans from related parties consist of:

	1996	1995
Note payable (US\$826 in 1996; US\$2,810 in 1995) to the former owner of an acquired company who is a director of the Company (i)	\$ 1,132	\$ 3,835
Mortgage payable to a company owned in part by a director of the Company (ii)	—	1,236
	1,132	5,071
Less current maturities of loans	1,132	3,943
	\$ —	\$ 1,128

(i) The \$1,132 (1995 – \$3,835) advance is unsecured and bears interest at US prime plus 2% per annum and is payable in monthly installments of \$226 plus interest.

(ii) The mortgage was secured by the property acquired and bore interest at a rate of 12.84% per annum. This mortgage was paid in full in January 1996 and therefore was included as part of current maturities at December 31, 1995.

18. CANADIAN AND UNITED STATES ACCOUNTING PRINCIPLES *(in thousands)*

These consolidated financial statements have been prepared in accordance with Canadian GAAP which conforms in all material respects with US generally accepted accounting principles ("US GAAP") except as noted below:

(a) Balance Sheets

The Financial Accounting Standards Board SFAS No. 109 "Accounting for Income Taxes" requires pre-acquisition losses to be recognized as a reduction in goodwill rather than as a reduction in the income tax provision. Therefore, under US GAAP, the goodwill and the retained earnings disclosed in the Consolidated Balance Sheets at December 31, 1996 and 1995 would be reduced by \$4,652 and \$4,777 respectively.

The separate reporting of the liability and equity components of a financial instrument required by the January 1996 pronouncement by the CICA referred to in note 11 to the Consolidated Financial Statements as Section 3860, is not permitted under US GAAP. Therefore, the restatement of the Company's Consolidated Financial Statements discussed in note 11 must be eliminated to reflect US GAAP. Specifically, under US GAAP, the liability represented by the 6% convertible subordinated debentures would be \$163,629 at December 31, 1995, the other paid in capital at December 31, 1995 would be zero, and the share capital of the Company would be \$469,853 at December 31, 1996.

The retained earnings of the Company would be \$150,875, \$112,182, and \$76,841 as at December 31, 1996, 1995 and 1994, respectively, after adjusting for the impact of Section 3860 as discussed above and adjusting for Luntz as described in paragraph (b) of this note.

(b) Statements of Earnings

The statements of earnings for the years ended December 31, 1996, 1995, and 1994 have to be adjusted to eliminate the effect of the increased interest expense required under CICA Section 3860, which is not permitted under US GAAP (note 11 to the Consolidated Financial Statements).

In addition, under US GAAP, the revenue and expenses of Luntz would not have been included in

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

18. CANADIAN AND UNITED STATES ACCOUNTING PRINCIPLES *(continued)*

the Consolidated Statements of Earnings until such time as the Shareholders of Luntz had definitively approved the purchase and sale agreement which occurred on or about December 23, 1996. In 1994, the Company had negotiated a separate line of credit which provided the Company with flexibility if the former minority shareholder of Intersan exercised his right to require the Company to purchase his

minority interest in Intersan for \$30 million in common shares of the Company. The Company therefore deleted these shares from the calculation of the fully diluted earnings per share for the year ended December 31, 1994. As a result, the basic earnings per share for the year ended December 31, 1994 would not be materially different under US GAAP, but the fully diluted earnings per share for the year ended December 31, 1994 would be reduced.

The consolidated statements of earnings which follow have been adjusted to disclose the above noted differences between Canadian GAAP and US GAAP.

	Years Ended December 31		
<i>(in thousands of Canadian dollars except per share amounts)</i>	1996	1995	1994
Revenue	\$742,975	\$ 648,311	\$489,740
Operating expenses	584,783	505,281	380,134
Gross profit	158,192	143,030	109,606
Expenses			
Selling, general and administrative	79,664	69,309	53,114
Interest - short-term	1,180	2,089	2,355
- long term	20,977	23,468	16,984
Amortization of goodwill	7,626	7,052	5,971
Other	(4,708)	(3,689)	(2,122)
	104,739	98,229	76,302
Earnings from continuing operations before tax	53,453	44,801	33,304
Income taxes	13,755	12,354	8,769
Earnings from continuing operations	39,698	32,447	24,535
Discontinued operations (net of tax)	(1,005)	2,894	2,502
Net earnings	\$ 38,693	\$ 35,341	\$ 27,037
Basic earnings per share			
Continuing operations	\$ 0.79	\$ 0.87	\$ 0.68
Discontinued operations	\$ (0.02)	\$ 0.08	\$ 0.07
	\$ 0.77	\$ 0.95	\$ 0.75
Fully diluted earnings per share			
Continuing operations	\$ 0.69	\$ 0.68	\$ 0.55
Discontinued operations	\$ (0.01)	\$ 0.05	\$ 0.02
	\$ 0.68	\$ 0.73	\$ 0.57
Weighted average number of commons shares outstanding	50,073	37,342	36,209

(c) Statements of Changes in Financial Position

Amounts included in the Consolidated Statements of Changes in Financial Position include items which were of a non-cash transaction basis and would not

be included for US GAAP reporting. The following is a summary of the changes in operating, investing and financing activities under US GAAP.

	Years Ended December 31		
<i>(in thousands of Canadian dollars)</i>	1996	1995	1994
Operating Activities			
Net earnings from continuing operations	\$ 39,698	\$ 32,447	\$ 24,535
Items included in earnings not affecting cash	50,307	39,837	32,857
Cash flow from continuing operations	90,005	72,284	57,392
Change in non-cash working capital	(154,172)	(51,286)	(71,312)
Cash provided by (used in) continuing operating activities	(64,167)	20,998	(13,920)
Cash provided by discontinued operating activities	28,830	15,114	21,649
Cash provided by (used in) operating activities	(35,337)	36,112	7,729
Investing Activities			
Proceeds from sale of solid waste operations	187,510	—	—
Acquisitions – including acquired cash (bank indebtedness)	(151,821)	(3,887)	(7,997)
Purchase of fixed assets	(40,877)	(32,044)	(23,510)
Other - net	(44,291)	(30,800)	(11,489)
Cash used in continuing investing activities	(49,479)	(66,731)	(42,996)
Cash used in investing activities of discontinued operations	(17,307)	(15,237)	(18,421)
Cash used in investing activities	(66,786)	(81,968)	(61,417)
Financing Activities			
Proceeds from borrowings of long-term debt	294,820	44,585	185,348
Principal payments of long-term debt	(255,914)	(11,927)	(108,675)
Common shares issued	84,179	189	893
Cash provided by continuing financing activities	123,085	32,847	77,566
Cash used in financing activities of discontinued operations	(12,683)	(2,795)	(1,638)
Cash provided by financing activities	110,402	30,052	75,928

There is no impact on the Company's cash position as a result of the variances between Canadian GAAP and US GAAP.

(d) Cash Flow Disclosure

The following supplemental cash flow disclosure would be provided under US GAAP.

	1996	1995	1994
Cash paid for interest	\$ 26,551	\$ 37,701	\$ 26,459
Cash paid for income taxes	\$ 1,526	\$ 3,168	\$ 3,919

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

19. CONTINGENCIES (in thousands)

(a) Certain operating subsidiaries acquired by the Company have been named as a potentially responsible or liable party in respect of several US federal or state superfund sites. These proceedings are principally based on allegations that the subsidiaries (or their predecessors) disposed of hazardous substances at the sites in question. Based on its review of these claims, the Company has estimated its share of the cost to remediate these sites and has accrued \$574 as at December 31, 1996 (1995 – \$1,332) to cover these costs, as disclosed in the table below.

(b) Certain of the Company's US subsidiaries' transfer, storage and disposal facilities are contaminated as a result of operating practices at the sites prior to their acquisition by the Company. Investigations of these sites have substantially characterized the nature and extent of the contamination.

The subsidiaries, in conjunction with US federal and state environmental regulatory agencies, have developed corrective action plans for the sites and in some instances have commenced to remediate the sites in accordance with approved corrective action plans. The Company estimates the remaining liability to remediate these sites to be \$26,650 and has accrued this amount in its December 31, 1996 financial statements (1995 – \$24,322).

The contingent liabilities discussed under parts (a) and (b) of this note are disclosed in the Consolidated Balance Sheets as follows:

	1996	1995
Accounts payable and accrued liabilities	\$ 1,405	\$ 1,547
Accrued environmental and closure costs (note 10)	25,819	24,107
	<u>\$ 27,224</u>	<u>\$ 25,654</u>

(c) The Company is named as a defendant in several lawsuits which have arisen in the ordinary course of its business. Management believes that none of these suits is likely to have a material adverse effect on the Company's business or financial condition and therefore has made no provision in these financial statements for the potential liability if any.

20. COMMITMENTS (in thousands)

Future rental payments required under operating leases for premises and equipment are as follows:

1997	\$ 9,850
1998	8,389
1999	5,898
2000	4,080
2001 and thereafter	6,248

Letters of credit issued in relation to various supply contracts and third party insurance policies amounted to \$18,400 as at December 31, 1996 (1995 – \$6,294).

21. SEGMENTED INFORMATION (in thousands)

The Company operates in one business segment but has a significant component of US based revenues and earnings. The geographic segmentation of the Company's business is as follows:

	1996		1995	
	Canada	US	Canada	US
Revenue	\$ 429,037	\$ 373,453	\$ 434,857	\$ 213,454
Gross profit	\$ 113,044	\$ 51,738	\$ 100,135	\$ 42,895
Total assets	\$ 782,230	\$ 563,489	\$ 705,709	\$ 297,203

DIRECTORS

Allen Fracassi ⁽³⁾
President & Chief Executive Officer
Philip Environmental Inc.

Philip Fracassi ⁽³⁾
Executive Vice-President & Chief Operating Officer
Philip Environmental Inc.

Howard Beck, Q.C. ⁽¹⁾⁽³⁾⁽⁴⁾⁽⁵⁾
Chairman
Philip Environmental Inc.

Roy Cairns, Q.C. ⁽²⁾⁽⁴⁾⁽⁵⁾
Counsel
Chown, Cairns

Norman Foster ⁽³⁾
President
By-Products Recovery Group
Philip Environmental Inc.

Felix Pardo ⁽¹⁾⁽⁵⁾
President
Ruhr-American Coal Corporation

Derrick Rolfe ⁽¹⁾⁽²⁾⁽⁴⁾⁽⁵⁾
President & Chief Executive Officer
RM Capital Corporation

Herman Turkstra ⁽⁵⁾
Counsel
Turkstra, Mazza, Shinehoft,
Mihailovich Associates

Robert Waxman ⁽²⁾
President
Metals Recovery Group
Philip Environmental Inc.

- (1) Audit Committee
- (2) Environmental Committee
- (3) Executive Committee
- (4) Compensation Committee
- (5) Corporate Governance Committee

OFFICERS

Howard Beck, Q.C.
Chairman

Allen Fracassi
President & Chief Executive Officer

Philip Fracassi
Executive Vice-President & Chief Operating Officer

Marvin Boughton, C.A.
Executive Vice-President & Chief Financial Officer

Peter Chodos
Executive Vice-President,
Corporate Development

Norman Foster
President, By-Products Recovery Group

Jerry Penland
President, Environmental Services Group

Antonio Pingue
Senior Vice-President,
Corporate & Government Affairs

Stuart Smith
President, Philip Utilities Management Corporation

Colin Soule
Senior Vice-President, General Counsel & Corporate Secretary

Robert Waxman
President, Metals Recovery Group

John Woodcroft, C.A.
Senior Vice-President, Operations

Si vous désirez recevoir un exemplaire de la version française de ce rapport, veuillez communiquer avec le service des relations avec les investisseurs de Hamilton à l'adresse qui figure à la page suivante.

CORPORATE INFORMATION

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Hamilton, Ontario

GROUP HEADQUARTERS:

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Hamilton, Ontario

By-Products Recovery Group
Detroit, Michigan

Environmental Services Group
Pittsburgh, Pennsylvania

Philip Utilities Management Corporation
Hamilton, Ontario

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Toll free investor information fax-back service:
1-800-617-3844

SHARE LISTING

The Common Shares of the Company are listed for trading on The Toronto Stock Exchange and The Montreal Exchange under the ticker symbol "PEN" and on the New York Stock Exchange under the symbol "PEV".

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ANNUAL MEETING

Shareholders are invited to attend the Annual Meeting to be held on May 21, 1997 at 4:30 p.m. at the Canadian Broadcasting Centre, Glen Gould Studio Auditorium, 250 Front Street West, Toronto, Ontario, Canada.



*Jose Sequeira, Samuel Dussard
Philip Environmental Services Group*



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